THE IMPACT OF THE IOWA FRANCHISE LAW ON
RESTAURANT FRANCHISOR EXPANSION STRATEGY

by

Angela L. M. Hurst

Dr. Mahmood Khan, Chairman

Department of Hospitality and Tourism Managment

(ABSTRACT)

The enormous success of franchising as an expansion instrument has resulted in a franchising boom over the past few decades. In response to the success of franchising as a business expansion method and the subsequent complaints by unsuccessful or defrauded franchisees, legislation was enacted at the federal and state level to attempt to prevent franchisor abuses. The 1992 Iowa Franchise Law has been called the most controversial and restrictive piece of franchise legislation in recent memory.

The purpose of this research project was to determine the impacts of the 1992 Iowa Franchise Law and its 1995 Amendments on restaurant franchisor expansion strategy, litigation with franchisees, and operational changes. The study sought information from US restaurant franchisors who may have been impacted by the law.

The research instrument consisted of a self-administered questionnaire, which was sent to 203 restaurant franchisors. A total of 36 companies responded and participated in the study. The results indicated that the law had an impact on expansion strategy of those who responded, specifically in the area of granting new franchised units. The results are representative of smaller businesses with less than 500 units.

REPORT DOCUMENTATION PAGE

Form Approved
OMB No. 0704-0188

1. AGENCY USE ONLY *(Leave blank)*

2. REPORT DATE
18 JUN 97

3. REPORT TYPE AND DATES COVERED

4. TITLE AND SUBTITLE
THE IMPACT OF THE IOWA FRACHISE LAW ON RESTAURANT FRANCHISOR EXPANSION STRATEGY

5. FUNDING NUMBERS

6. AUTHOR(S)
ANGELA L.M. HURST

7. PERFORMING ORGANIZATION NAME(S) AND ADDRESS(ES)
VIRGINIA TECH UNIVERSITY

8. PERFORMING ORGANIZATION REPORT NUMBER
97-069

9. SPONSORING/MONITORING AGENCY NAME(S) AND ADDRESS(ES)
DEPARTMENT OF THE AIR FORCE
AFIT/CI
2950 P STREET
WRIGHT-PATTERSON AFB OH 45433-7765

10. SPONSORING/MONITORING AGENCY REPORT NUMBER

11. SUPPLEMENTARY NOTES

12a. DISTRIBUTION AVAILABILITY STATEMENT

12b. DISTRIBUTION CODE

13. ABSTRACT *(Maximum 200 words)*

14. SUBJECT TERMS

15. NUMBER OF PAGES
106

16. PRICE CODE

17. SECURITY CLASSIFICATION OF REPORT

18. SECURITY CLASSIFICATION OF THIS PAGE

19. SECURITY CLASSIFICATION OF ABSTRACT

20. LIMITATION OF ABSTRACT

References

Allen, R. L. (1992). Franchise legislation facing radical change: Bills in 19 states target business relationships between restaurant franchisees and franchisors. Nation's Restaurant News, 26 (38), 1, 158.

American Legislative Exchange Council. (1996). Restrictive Franchising Laws. The State Factor, 22 (6).

Anonymous (1996). Franchisee vs. Franchisor: Balancing the scales. Nation's Business, 84 (10), 63.

Anonymous. (1995, July). R&I Top 400. Restaurants & Institutions, 105 (16), 42-86.

Anonymous. (1995, August 7). The Top 100. Nation's Restaurant News, 29 (31), 81-144.

Anonymous. (1995, August 23). Domino's violates antitrust law, franchisees claim. [On-line]. Available: http://www.ifis.com/ifis/new/pizza2.html.

Anonymous. (1995). Iowa franchise law reform bill passes, house: US Supreme Court refuses appeal. Franchising World, 27 (2), 38.

Anonymous. (1994, July 25). Iowa Franchise Law Held Unconstitutional. The National Law Journal, D3.

Anonymous. (1993). Popeye's Open in Wal-Mart. Franchising World, 25 (6), 16.

Armstrong, J. and Overton, T. (1977). Estimating non-response bias in mail surveys. Journal of Marketing Research, 14 (August), 396-402.

Bernstein, C. (1994). Franchising: explosive issues fuel debate. Restaurants & Institutions, 104 (24), 61.

Brickley, J., Dark, F., and Weisbach, M.. (1991). The economic effects of franchise termination laws. Journal of Law and Economics, 34 (1), 101-132.

Brown, H. (1995, July 25). Iowa's revised statute on conduct. New York Law Journal, 3.

Bureau of National Affairs. (1995). Iowa supreme court construes franchise act in attack on constitution. BNA Antitrust and Trade Regulation Report, 69 (1732), 394.

Caggiano, C. (1995). The collectively bargained franchise agreement. Inc., 17 (16), 73-75.

Chase, B. (1991). Franchisees seek legislative protection. Business Record, 87 (42), 1.

Committee on Small Business. (1990). Franchising in the U.S. Economy: Prospects and Problems. U.S. House of Representatives, 101st Congress, 2d session, September 1990.

Couch, M. (1996, February 4). Restaurants open at fast rate as franchise law is sorted out. The jury is still out on what effect Iowa's tough rules have had on the industry. The Des Moines Register, p. 4.

Diamond, S.A. (1969, October 27). Federal Trade Commissioners warn of abuses in franchising. Marketing Insights, p. 17.

Gleim, I. and Jordon, B. (1995). Business Law/Legal Studies, Chapter 37. http://www.gleim.com/BusinessLaw/Government/Antitrust.html

Goodhard, K. (1992, Summer). The New Iowa Franchise Law: franchisors (and franchisees) beware. Franchise Law Journal 18.

Hess, D. (1995). The Iowa Franchise Act: Towards Protecting Reasonable Expectations of Franchisees and Franchisors. Iowa Law Review, 80, 333-362.

Hogan, B. (1993). Franchise Wars. D&B Reports, 42 (5), 40-42.

International Franchise Association. (1995). Franchise Fact Sheet.

International Franchise Association. (1996). Franchise Opportunities Guide, 1996 Edition. Washington D.C.: International Franchise Association.

Iowa Coalition for Responsible Franchising. (1995). 1995 Iowa Franchise Report. West Des Moines: Iowa Coalition for Responsible Franchising.

Iowa Coalition for Responsible Franchising. (1996). 1996 Iowa Franchise Update. West Des Moines: Iowa Coalition for Responsible Franchising.

Iowa code 523H, Franchise Agreements. 1992 Iowa Acts 1134 (codified at Iowa Code 523H.1-.17 (1993))

Iowa code 523H, Laws of 1995, House File 126 (codified at Iowa Code 523H.1-.17).

Judge tosses out lawsuit on ingredients supplied by Domino's. (1996, May 3). The Wall Street Journal, p. B11(E).

Justis, R.T. and Judd, R. (1986). Master Franchising: A new look. Journal of Small Business Management, 24 (3), 16-21.

Justis, R. (1989). Franchising. Cincinnati, OH: South-Western Publishing Co.

Kaufmann, D. (1990a). New York Franchise Act celebrates 10th anniversary. New York Law Journal, September 5, 1.

Kaufmann, D. (1990b). Franchising is alive and well, so let's kill it. New York Law Journal, September 25, 2.

Khan, M. (1992). Restaurant Franchising Von Nostrand Reinhold, Inc.: New York.

King, J. (1993a). Iowa become battlefield for franchise legislation. Business Record, 89 (14), 10.

King, J. (1993b). Franchise Companies welcome court ruling. Business Record, 89 (22), 3.

King, J. (1994). Iowa Franchise Act in national light. Business Record, 90 (31), 3.

King, J. (1995). Franchise companies may return to Iowa. Business Record, 91 (19), 8.

Kramer L. (1995). Popeye's to open outlets in Kroger supermarkets. Nation's Restaurant News, 29 (28), 1.

Law and Leading Attorney Web. (1996, October 6). The UFOC. [On-line]. Available: http://www.lawlead.con/minnesota/business/chapters/619.html.

Mandt, M. E. (1992). The Economic Effects of Franchise Termination Laws. (Thesis, University of Georgia, 1992).

Martin, R. (1995). The Second 100. Nation's Restaurant News, 29 (33), 49-68.

Mendelshon, M. (1992). The Guide to Franchising. New York: Cassell Publishing

Oleck, J. (1992). The Battle for Iowa. Restaurant Business, 91 (8), 78-92.

Oleck, J. (1993a). 'Grassroots' group aims to undo franchise law: historic Iowa legislation is target of coalition. Restaurant Business, 92 (7) 22.

Oleck, J. (1993b). Iowa franchise interests await appeal ruling: McDonald's wants District Court upheld. Restaurant Business, 92 (10), 43.

Peterson, J. (1993). Business meals return to the gilded age. Business Record, 89 (48), 14.

Prewitt, M. (1995). Franchisees' Lawsuits: Chains nontraditional growth paths lead to new encroachment battles. Nation's Restaurant News, 29 (40). 118-120.

Purvin, R. (1994). The Franchise Fraud. New York: John Wiley & Sons, Inc.

Regulation of the Franchising Industry: Hearings before the Federal Trade Commission House Energy/Transportation and Hazardous Materials, 104th Cong., 2d Sess. (1994) (testimony of C. White).

Regulation of the Franchising Industry: Hearings before the North American Securities Administrators Association House Energy/Transportation and Hazardous Materials Federal Trade Commission, 104th Cong., 2d Sess. (1994) (testimony of Steve Maxey).

Runkel, P. J., and McGrath, J. E. (1972). Research on Human Behavior: A Systematic Guide to Method. New York: Holt, Rinehart & Winston.

Saporito, B. (1995). What's for dinner? The battle for stomach share. Fortune, 131 (9), 50-56.

Serwer, A. (1995). Trouble in franchise nation. Fortune, 131 (4), 115-129.

Shay, M. (1996). Vote to keep franchising strong. Franchising World, 28 (4), 12-13.

Sherry, J. (1996). Antitrust implications of food-service franchising agreements. Cornell Hotel and Restaurant Administration Quarterly, 37 (4), 18-19.

Siegal v. Chicken Delight, Inc., 448 F 2nd. 43 (9th Cir. 1974).

Tannenbaum, J. (1995, July 5). Franchisees balk at high prices for supplies from franchisors. The Wall Street Journal, p. B1.

Taylor, G. (1992). Franchise reform to yield feast. The National Law Journal, January 20, 1.

U.S. Constitution, art.1, section 10, clause 1 (1787).

Wall, S., and Wieczorek, D. (1993, July 12). New disclosure guidelines await review. The National Law Journal, 19.

Whittemore, M. (1994). Winds of change in franchising. Nation's Business, 82 (1) 49.

Wieczorek, D. (1995, Fall). The Iowa Franchise Law: 1995 Amendments and some proposals for 1996. Franchise Law Journal, 43-50.

Zikmund, W. (1997). Business Research Methods. (Fifth Edition). Orlando: The Dryden Press.

THE IMPACT OF THE IOWA FRANCHISE LAW ON
RESTAURANT FRANCHISOR EXPANSION STRATEGY

by

Angela L. M. Hurst

Dr. Mahmood Khan, Chairman

Department of Hospitality and Tourism Managment

(ABSTRACT)

The enormous success of franchising as an expansion instrument has resulted in a franchising boom over the past few decades. In response to the success of franchising as a business expansion method and the subsequent complaints by unsuccessful or defrauded franchisees, legislation was enacted at the federal and state level to attempt to prevent franchisor abuses. The 1992 Iowa Franchise Law has been called the most controversial and restrictive piece of franchise legislation in recent memory.

The purpose of this research project was to determine the impacts of the 1992 Iowa Franchise Law and its 1995 Amendments on restaurant franchisor expansion strategy, litigation with franchisees, and operational changes. The study sought information from US restaurant franchisors who may have been impacted by the law.

The research instrument consisted of a self-administered questionnaire, which was sent to 203 restaurant franchisors. A total of 36 companies responded and participated in the study. The results indicated that the law had an impact on expansion strategy of those who responded, specifically in the area of granting new franchised units. The results are representative of smaller businesses with less than 500 units.

References

Allen, R. L. (1992). Franchise legislation facing radical change: Bills in 19 states target business relationships between restaurant franchisees and franchisors. Nation's Restaurant News, 26 (38), 1, 158.

American Legislative Exchange Council. (1996). Restrictive Franchising Laws. The State Factor, 22 (6).

Anonymous (1996). Franchisee vs. Franchisor: Balancing the scales. Nation's Business, 84 (10), 63.

Anonymous. (1995, July). R&I Top 400. Restaurants & Institutions, 105 (16), 42-86.

Anonymous. (1995, August 7). The Top 100. Nation's Restaurant News, 29 (31), 81-144.

Anonymous. (1995, August 23). Domino's violates antitrust law, franchisees claim. [On-line]. Available: http://www.ifis.com/ifis/new/pizza2.html.

Anonymous. (1995). Iowa franchise law reform bill passes, house: US Supreme Court refuses appeal. Franchising World, 27 (2), 38.

Anonymous. (1994, July 25). Iowa Franchise Law Held Unconstitutional. The National Law Journal, D3.

Anonymous. (1993). Popeye's Open in Wal-Mart. Franchising World, 25 (6), 16.

Armstrong, J. and Overton, T. (1977). Estimating non-response bias in mail surveys. Journal of Marketing Research, 14 (August), 396-402.

Bernstein, C. (1994). Franchising: explosive issues fuel debate. Restaurants & Institutions, 104 (24), 61.

Brickley, J., Dark, F., and Weisbach, M.. (1991). The economic effects of franchise termination laws. Journal of Law and Economics, 34 (1), 101-132.

Brown, H. (1995, July 25). Iowa's revised statute on conduct. New York Law Journal, 3.

Bureau of National Affairs. (1995). Iowa supreme court construes franchise act in attack on constitution. BNA Antitrust and Trade Regulation Report, 69 (1732), 394.

Caggiano, C. (1995). The collectively bargained franchise agreement. Inc., 17 (16), 73-75.

Chase, B. (1991). Franchisees seek legislative protection. Business Record, 87 (42), 1.

Committee on Small Business. (1990). Franchising in the U.S. Economy: Prospects and Problems. U.S. House of Representatives, 101st Congress, 2d session, September 1990.

Couch, M. (1996, February 4). Restaurants open at fast rate as franchise law is sorted out. The jury is still out on what effect Iowa's tough rules have had on the industry. The Des Moines Register, p. 4.

Diamond, S.A. (1969, October 27). Federal Trade Commissioners warn of abuses in franchising. Marketing Insights, p. 17.

Gleim, I. and Jordon, B. (1995). Business Law/Legal Studies, Chapter 37. http://www.gleim.com/BusinessLaw/Government/Antitrust.html

Goodhard, K. (1992, Summer). The New Iowa Franchise Law: franchisors (and franchisees) beware. Franchise Law Journal 18.

Hess, D. (1995). The Iowa Franchise Act: Towards Protecting Reasonable Expectations of Franchisees and Franchisors. Iowa Law Review, 80, 333-362.

Hogan, B. (1993). Franchise Wars. D&B Reports, 42 (5), 40-42.

International Franchise Association. (1995). Franchise Fact Sheet.

International Franchise Association. (1996). Franchise Opportunities Guide, 1996 Edition. Washington D.C.: International Franchise Association.

Iowa Coalition for Responsible Franchising. (1995). 1995 Iowa Franchise Report. West Des Moines: Iowa Coalition for Responsible Franchising.

Iowa Coalition for Responsible Franchising. (1996). 1996 Iowa Franchise Update. West Des Moines: Iowa Coalition for Responsible Franchising.

Iowa code 523H, Franchise Agreements. 1992 Iowa Acts 1134 (codified at Iowa Code 523H.1-.17 (1993))

Iowa code 523H, Laws of 1995, House File 126 (codified at Iowa Code 523H.1-.17).

Judge tosses out lawsuit on ingredients supplied by Domino's. (1996, May 3). The Wall Street Journal, p. B11(E).

Justis, R.T. and Judd, R. (1986). Master Franchising: A new look. Journal of Small Business Management, 24 (3), 16-21.

Justis, R. (1989). Franchising. Cincinnati, OH: South-Western Publishing Co.

Kaufmann, D. (1990a). New York Franchise Act celebrates 10th anniversary. New York Law Journal, September 5, 1.

Kaufmann, D. (1990b). Franchising is alive and well, so let's kill it. New York Law Journal, September 25, 2.

Khan, M. (1992). Restaurant Franchising Von Nostrand Reinhold, Inc.: New York.

King, J. (1993a). Iowa become battlefield for franchise legislation. Business Record, 89 (14), 10.

King, J. (1993b). Franchise Companies welcome court ruling. Business Record, 89 (22), 3.

King, J. (1994). Iowa Franchise Act in national light. Business Record, 90 (31), 3.

King, J. (1995). Franchise companies may return to Iowa. Business Record, 91 (19), 8.

Kramer L. (1995). Popeye's to open outlets in Kroger supermarkets. Nation's Restaurant News, 29 (28), 1.

Law and Leading Attorney Web. (1996, October 6). The UFOC. [On-line]. Available: http://www.lawlead.con/minnesota/business/chapters/619.html.

Mandt, M. E. (1992). The Economic Effects of Franchise Termination Laws. (Thesis, University of Georgia, 1992).

Martin, R. (1995). The Second 100. Nation's Restaurant News, 29 (33), 49-68.

Mendelshon, M. (1992). The Guide to Franchising. New York: Cassell Publishing

Oleck, J. (1992). The Battle for Iowa. Restaurant Business, 91 (8), 78-92.

Oleck, J. (1993a). 'Grassroots' group aims to undo franchise law: historic Iowa legislation is target of coalition. Restaurant Business, 92 (7) 22.

Oleck, J. (1993b). Iowa franchise interests await appeal ruling: McDonald's wants District Court upheld. Restaurant Business, 92 (10), 43.

Peterson, J. (1993). Business meals return to the gilded age. Business Record, 89 (48), 14.

Prewitt, M. (1995). Franchisees' Lawsuits: Chains nontraditional growth paths lead to new encroachment battles. Nation's Restaurant News, 29 (40). 118-120.

Purvin, R. (1994). The Franchise Fraud. New York: John Wiley & Sons, Inc.

Regulation of the Franchising Industry: Hearings before the Federal Trade Commission House Energy/Transportation and Hazardous Materials, 104th Cong., 2d Sess. (1994) (testimony of C. White).

Regulation of the Franchising Industry: Hearings before the North American Securities Administrators Association House Energy/Transportation and Hazardous Materials Federal Trade Commission, 104th Cong., 2d Sess. (1994) (testimony of Steve Maxey).

Runkel, P. J., and McGrath, J. E. (1972). Research on Human Behavior: A Systematic Guide to Method. New York: Holt, Rinehart & Winston.

Saporito, B. (1995). What's for dinner? The battle for stomach share. Fortune, 131 (9), 50-56.

Serwer, A. (1995). Trouble in franchise nation. Fortune, 131 (4), 115-129.

Shay, M. (1996). Vote to keep franchising strong. Franchising World, 28 (4), 12-13.

Sherry, J. (1996). Antitrust implications of food-service franchising agreements. Cornell Hotel and Restaurant Administration Quarterly, 37 (4), 18-19.

Siegal v. Chicken Delight, Inc., 448 F 2nd. 43 (9th Cir. 1974).

Tannenbaum, J. (1995, July 5). Franchisees balk at high prices for supplies from franchisors. The Wall Street Journal, p. B1.

Taylor, G. (1992). Franchise reform to yield feast. The National Law Journal, January 20, 1.

U.S. Constitution, art.1, section 10, clause 1 (1787).

Wall, S., and Wieczorek, D. (1993, July 12). New disclosure guidelines await review. The National Law Journal, 19.

Whittemore, M. (1994). Winds of change in franchising. Nation's Business, 82 (1) 49.

Wieczorek, D. (1995, Fall). The Iowa Franchise Law: 1995 Amendments and some proposals for 1996. Franchise Law Journal, 43-50.

Zikmund, W. (1997). Business Research Methods. (Fifth Edition). Orlando: The Dryden Press.

THE IMPACT OF THE IOWA FRANCHISE LAW ON RESTAURANT FRANCHISOR EXPANSION STRATEGY: AN EXPLORATORY STUDY

by

Angela L. M. Hurst

Dr. Mahmood Khan, Chairman

Department of Hospitality and Tourism Management

(ABSTRACT)

The enormous success of franchising as an expansion instrument has resulted in a franchising boom over the past few decades. In response to the success of franchising as a business expansion method and the subsequent complaints by unsuccessful or defrauded franchisees, legislation was enacted at the federal and state level in an attempt to prevent franchisor abuses. The 1992 Iowa Franchise Law has been called the most controversial and restrictive piece of franchise legislation in recent memory.

The purpose of this research project is to determine the impacts of the 1992 Iowa Franchise Law and its 1995 Amendments on restaurant franchisor expansion strategy, litigation with franchisees, and operational changes. The study sought information from US restaurant franchisors who may have been impacted by the law.

The research instrument consisted of a self-administered questionnaire, which was sent to 203 restaurant franchisors. A total of 36 companies responded and participated in the study.

The results indicated that the law had an impact on expansion strategy of those who responded, specifically in the area of granting new franchised units. The results are representative of smaller businesses with less than 500 units.

ACKNOWLEDGMENT

I would like to express my gratitude to those who contributed to the successful completion of this study. The faculty, staff, and my peers at Virginia Tech have been very supportive and encouraging throughout my studies at the University. I have thoroughly enjoyed the time spent in fellowship and work with everyone at the department.

My appreciation goes to Dr. Mahmood Khan, my advisory committee chairman. Dr. Khan has provided invaluable insight, support, and encouragement which have been an integral part of my successful completion of the Master's program.

I sincerely thank Dr. Eliza Tse, who has always taken time to provide feedback and suggestions which have added significantly to the quality of this work.

My deep appreciation is extended to Mr. Eugene Rackley for providing priceless direction and assistance throughout this research project, as well as for his valuable industry perspective.

I would like to thank my husband, Jeffrey Hurst who has provided me with unwavering support. I love you! Finally, I wish to thank my Lord and my God who has given me the skills and abilities to successfully complete this work and who provided me the opportunity to do so.

TABLE OF CONTENTS

List of Figures

List of Tables

CHAPTER ONE

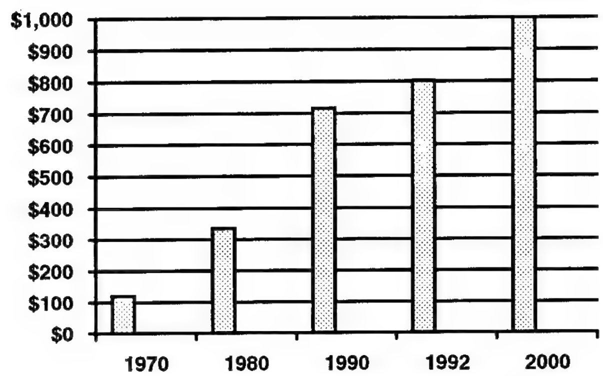
INTRODUCTION

Background

Franchising has contributed a great deal to the growth of the U.S. economy since the mid-1900s. Because of its enormous success as an expansion instrument, franchising has become a preferred growth method for companies of all sorts, from dating and employment services to restaurants and auto stores. Starting in 1853 with Isaac Singer's sewing machines (Mendelshon, 1992; Kaufmann, 1990a) and continuing throughout the 20th century, the franchising strategy was used in many different industries in the United States, including the hospitality industry. Franchisors in the first half of the twentieth century included A&W root beer stands, Howard Johnson Restaurants and Motels and Baskin Robbins ice cream. Franchising truly came of age in the 1950s and the decade of the 1960's (Kaufmann, 1990a). The most notable franchisor of all time, McDonald's, began franchising in the 1950s. The success and expansion of these chains led to increased franchising in the 1960s and 70s throughout the country and in many different industries.

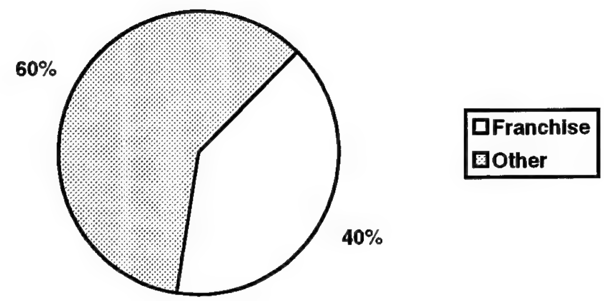
Franchising continued to grow throughout the 1980s and 90s, becoming a significant force in the nation's economy. In 1990, sales of goods and services by restaurant franchising companies was estimated to have exceeded $64 billion. In 1992 alone, franchising of all business types accounted for $803 billion in sales and 8 million jobs (International Franchise Association, 1996) (Figure 1). A study commissioned by the International Franchise Association (IFA) projects that by the turn of the century,

franchise sales will account for half of all retail sales in the United States (Regulation of franchising, 1994b); currently 40% of retail sales are from franchises (Figure 2). Because of the astounding success within the U.S., many businesses are turning their sights overseas as well, looking for new markets in which to expand and introduce their products and services.



Source: International Franchise Association, 1995 (beyond 1992 is projected growth)

Figure 1
US Franchise Sales (billions)



Source: International Franchise Association

Figure 2
Franchising as a Portion of US Retail Sales

Today as never before, franchising has become an accepted means by which the owner and developer (the franchisor) of a product or service enters into a private, contractual agreement with another party (the franchisee) giving that franchisee the right to use the franchisor's trademarks or other recognized forms of business goodwill to enhance the franchisee's business for a fixed period of time (Sherry, 1996). The boom in franchising as a business strategy led to incredible success for some, but failure for others as they either made poor business decisions or were conned by unethical franchisors. There was abuse of the system with the victimization of many by fly-by-night, unethical, inept and often criminal operators (Kaufmann, 1990a). The complaints of these citizens led the government to adapt various disclosure and registration requirements for businesses who franchised. Disclosure legislation had support from the franchising

industry, which wanted to avoid the bad reputation that could easily develop by unethical franchisors who misled potential investors.

In response to the success of franchising as a business expansion method and the subsequent complaints by unsuccessful or defrauded franchisees, legislation was enacted at the state level to ensure potential franchisees were fully informed about the risks and responsibilities they were taking. California led the way with its 1971 Franchise Investment Act, and soon the federal government followed by establishing the 'Franchise Rule' in 1979 (Wall and Wieczorek, 1993; Purvin, 1994; Regulation of Franchising, 1994b), which details areas of disclosure required when selling franchises. Despite these state and federal franchise laws, complaints and allegations of franchisor abuses toward franchisees have continued. In fact, since 1990 franchisee complaints filed against parent companies with the Federal Trade Commission have been growing at a more than 50% annual rate, now numbering in the hundreds (Serwer, 1995).

Legal problems in franchising fall in the three primary categories; disclosure, tying, and termination (Diamond, 1969). When problems cannot be solved amicably, litigation is often seen as the only solution. State and federal franchise laws attempt to preempt legal problems through various disclosure requirements, while antitrust laws address the issue of tying. Other problems, such as termination, are covered in various state laws that attempt to regulate the franchise relationship.

Problem Statement

With the extreme popularity of franchising as a method of expansion comes problems, such as allegations of franchisor misconduct or failure to deal in good faith. Because the franchisor is putting their business reputation on the line, the contracts are often very explicit in outlining detailed franchisee obligations and may provide only a general outline on the franchisor obligations. Federal law requires over 20 areas of disclosure by the franchisor to the franchisee (Khan, 1992), however often the franchisors reserve the right to expand, terminate, or non-renew upon their discretion, regardless of the performance of a franchisee. This is done to preserve the franchisor's ability to sever relationships with "bad apples" and to preserve the trademark for the entire franchise system. However some claim this power is abused by unfair terminations and non-renewals. It is argued that the franchisors are able to accomplish one-sided contracts because of their enormous financial and legal resources as well as general bargaining power. It is because of the perceived one-sidedness of these franchising contracts that state and federal franchise legislation has become a hot topic.

The 1992 Iowa Franchise Act and its 1995 Amendments attempt to address franchisee grievances; the law passed despite derailment efforts by the IFA, some franchisees, and several strong franchisors, who indicated that they would discontinue granting franchisee stores in the state if the law was passed. A primary area of concern with the Iowa Franchise Act is that it attempts to address the ongoing franchisor/franchisee relationship rather than disclosure or tying arrangements (Goodhard, 1992). The Iowa Coalition for Responsible Franchising (ICRF), an association of

franchisees and franchisors which was formed in response to the law (King, 1993a) reports that at least 133 companies, 27 of which are food service franchisors, have reduced or halted expansion in Iowa until the law is reformed or repealed. They estimate that over 7,000 jobs and $207 million in taxable revenue for the state have been lost as a direct result of this legislation. Furthermore, the American Legislative Exchange Council (ALEC) reported that 430 planned expansion stores were canceled as of January 1995 (ALEC, 1996). The ICRF claims that the losses are not limited to the jobs and revenues that were expected to have been generated by franchise units. They have extended to include franchisee suppliers, real estate companies who have lost opportunities to sell property to franchisees, construction companies, and business developers. Furthermore, many companies are hesitant to franchise and instead have restricted themselves to opening company owned stores, which may not provide the same benefits to the local economy that a franchised unit would since profits from company owned stores are returned to corporate headquarters, which are usually located outside of Iowa (ICRF, 1995).

Proponents of the law claim it has had no significant impact, citing statistics from the Iowa Department of Employment Services. In 1993, 2000 restaurant jobs were created in the state, and sales tax revenue from restaurants increased $27 million (Couch, 1996).

At least 30 states have considered similar legislation since the passage of the Iowa Act, but no bills have been passed, largely in part by successful lobbying by franchisors (King, 1994; ICRF, 1996) and franchisees alike. The consequences of the 1992 Iowa

Franchise Act and the subsequent 1995 Amendments in terms of franchise growth have yet to be fully explored. It is the purpose of this study to determine the specific results of this legislation in terms of restaurant franchise expansion within the state and subsequent litigation.

Theoretical Underpinnings

Franchisor/franchisee relationship

The ideal franchisor/franchisee relationship is one built on mutual trust, consideration, and cooperation and is vital for the success of both parties. It should involve shared effort and should enhance profits and maximize market share, product sales, and growth for the franchisor and franchisee (Justis, 1989). This mutually beneficial relationship is ideal; however many claim that franchising contracts are generally written in a manner which maximizes the position of the franchisor (Purvin, 1994).

The relationship between franchisor and franchisee has been broken down into four phases. The first is introduction, in which mutual interdependence and shared desire for success and profitability is fostered (Justis, 1989). The second phase is growth, which begins once the business is operational. At this point the relationship is developing and being solidified by the support provided by the franchisor to the new franchisee. However, if a franchisor provides poor training or support, the relationship can become strained at this point. The maturity phase is entered as each party understands what they can expect from each other. At this point the franchisee has a good picture of the competency and expertise of the franchisor and either begins to question or to value the

franchisor's contributions (Justis, 1989). The final phase of the relationship is the decline phase. Generally, one of two situations exist at this point. Either the business is going poorly and the franchisee is seeking possible termination of the contract, or the business is growing and the relationship with the franchisor is solidified (Justis, 1989).

The Iowa Franchise Legislation

Franchise legislation has become a battleground for many in the franchising community as evidenced by the strong reaction to franchise laws such as the Iowa Franchise Law, which is widely considered the most restrictive piece of franchise legislation in recent memory. Opponents of the Iowa Franchise Law see the legislation as an outright violation of their contractual rights guaranteed under the U.S. Constitution (1787), which states in article 1 section 10 that "no state shall... pass any... law impairing the obligation of contracts". Historically, franchisors and franchisees have relied heavily on the right to contract to set the terms and conditions of their relationship (ALEC, 1996).

Most authors distinguish between two general types of franchise laws. The first is the sales/disclosure laws which require franchisors to disclose information to prospective franchisees, such as financial information about the solvency of the franchise (Table 1). An example of this type of law is set forth in the federal Franchise Rule. The second category is relationship laws which mandate the conduct of the franchisor and franchisee regardless of the terms and conditions of the franchise agreement (ALEC, 1996). The Iowa Franchise Law is the most recent example of a law which falls in the "relationship" category (Table 2). Robert Purvin (1994), a franchisee advocate, has categorized franchise law into three primary categories: 1) franchise registration and disclosure acts,

2) franchise relationship acts, and 3) 'little' Federal Trade Commission acts (Purvin, 1994). Purvin sees the introduction of the Iowa Franchise Act as a fourth and very important category of franchise law: fair franchising practices.

While some franchisors, such as Taco John's have adapted to the legislation in hopes to form better franchisor-franchisee relationship and to further penetrate the market, others see legislation as an unnecessary government restriction on their rights to conduct business as they see fit. While the legislation has created a great amount of controversy, the battle lines are not drawn distinctly between franchisors and franchisees. One will find that there are some franchisees who side with franchisors against the law and a few franchisors who see the law as an opportunity rather than a threat and who are not working towards its repeal.

Proponents of increased legislation believe franchisor-franchisee relations will make great strides forward when franchisees are "empowered to negotiate the establishment of franchise practices" (Bernstein, 1994). Furthermore, Susan Kezios, the director of the American Franchisee Association hails the Iowa law as the "Franchisee Bill of Rights" (King, 1994), and believes the law is a great step forward for franchisees.

Table 1

States with Disclosure Laws

1. California	10. Maine	19. Oklahoma
2. Connecticut	11. Maryland	20. Oregon
3. Florida	12. Michigan	21. Rhode Island
4. Georgia	13. Nebraska	22. South Carolina
5. Hawaii	14. New Hampshire	23. South Dakota
6. Illinois	15. New York	24. Texas
7. Indiana	16. North Carolina	25. Utah
8. Iowa	17. North Dakota	26. Virginia
9. Kentucky	18. Ohio	27. Washington
		28. Wisconsin

Source: Law and Leading Attorneys, 1996

Table 2

States with Franchise relationship laws

1. Arkansas
2. California
3. Connecticut
4. Delaware
5. Hawaii
6. Illinois
7. Indiana
8. Iowa
9. Michigan
10. Minnesota
11. Mississippi
12. Missouri
13. Nebraska
14. New Jersey
15. Virginia
16. Washington
17. Wisconsin

Source: American Legislative Exchange Council, 1996

Objectives of the Study

The consequences of the 1992 Iowa Franchise Act and its 1995 Amendments in terms of restaurant franchise growth have yet to be fully explored. Proponents and opponents of the law each have published statistics which appear to support their respective positions, however no academic research on this particular law has been conducted to date. Additional research is needed to determine the impact the legislation has had on restaurant franchisor expansion within the state. It is the purpose of this paper to explore and determine the specific results of this legislation in terms of restaurant franchise expansion within the state, subsequent litigation with franchisees, and operational changes necessitated by the law.

The objectives of this study are based on the following research questions:

1) What impact have the 1992 Iowa Franchise Act and its 1995 Amendments had on the decisions of restaurant companies regarding unit expansion through granting new franchises or building company owned stores in Iowa?

2) What specific clauses of the law were the most influential in this decision making?

3) How were franchisors impacted in terms of litigation with franchisees as a direct result of the Iowa laws?

4) What specific clauses of the law were the most influential in the level of litigation with franchisees?

5) How were franchisors impacted in terms of operational changes as a result of the laws?

Contributions of the Study

This study will benefit researchers, franchisors, franchisees and legislative bodies considering franchise legislation. The study will show what impact, if any the Iowa Franchise Act has had on restaurant franchisor expansion strategy in regards to granting company owned and new franchisee stores and what specific areas of the law were most influential in these strategic decisions. This will enable legislatures to consider the possible consequences in terms of franchise growth when voting on franchise legislation. Likewise, franchisors and franchisees will benefit by seeing what impact such legislation has had in Iowa and how it may impact their own units throughout the country if such legislation is enacted in other states.

The study is limited in that it investigates the impact on food service franchises only, however the law is applicable to franchises of all kinds, to include hotels, dating services and other businesses.

Summary

This chapter presented an overview of the proposed research. Legislation which encourages franchise growth and good franchisor/franchisee relationships are key in maintaining this strong force in the U.S. and worldwide economy. However, these relationships become strained when controversial or poorly designed legislation which impacts both franchisees and franchisors is implemented.

The objective of the study is to investigate the specific impact the Iowa Franchise laws had on restaurant franchisor expansion strategy within the state. The results of this study will contribute to both the franchising and legislative communities and to the small but growing body of literature on the impact of franchise legislation.

CHAPTER TWO

REVIEW OF LITERATURE

Overview of Franchising

Franchising is defined as a legal agreement in which an owner, the franchisor, agrees to grant rights to another, the franchisee, to sell a product or service under specific conditions (Khan, 1992). There are two primary means of franchising, product and trade name franchising and business format franchising. Product and trade name franchising offers the right to distribute products in a territory and to use the manufacturers name. Examples of this type of franchising are soft drink bottlers and automobile dealers. Business format franchising is more complex in its requirements of both the franchisor and franchisee. In return for a licensing fee and royalties, a franchisor offers a complete business plan for the franchisee to follow. The plans are detailed and include operational procedures, marketing plans, specifications for signs and buildings, and general obligations of the franchisor and franchisee. The franchisee must uphold and meet all requirements outlined in the contract or risk losing the business and their investment. Business format franchises include restaurants, hotels, rental services and various other types of businesses.

In business format franchising, the relationship between the franchisor and franchisee is a very important aspect in the success of the business. Mutual understanding and satisfaction within the relationship can yield healthy results for both parties, however, if one party is perceived to have broken the trust or legal expectations of the other, legal trouble often ensues. Franchisors make every effort to cover all possible

situations in their franchising contracts, which can range from a few to over 50 pages (Serwer 1995). While the contract must cover the areas of disclosure required by law (Table 3), much of the bulk of the contract may dedicated to the responsibilities of the franchisee to the franchisor.

Strategy in Franchising

The continual effort to keep organizations matched to their environments has brought franchise disputes and franchise law into the spotlight. Many hospitality organizations depend on franchising as a method of expansion, primarily because it allows expansion of the company name and product with little monetary investment on the part of the franchisor. In order to remain competitive in today's business environment, franchisors have been forced to rethink strategy and make operational changes which impact suppliers, customers, competitors, and the franchisees. To increase market share and strengthen their competitive position, many franchise companies have turned to segmentation, mergers and acquisitions, increasing the level of franchise activity and opening 'non-traditional' franchising sites. Upgrading, renovation of old or outdated units, and strict control over non-renewing and terminating unprofitable sites are all part of competition and strategic decisions made by the franchisor. Many times, these strategic changes have unexpected financial implications for franchisees, requiring significant investment of time and money to keep up with the franchise system requirements. Often, these burdens lead to tension in the franchisee and franchisor relationship, which often leads to conflict so severe that it can be resolved only in court (Taylor, 1992).

The growing consumer demand for more convenience, especially in the food service segment, provides for new opportunities as well as for increased franchisor/franchisee problems. *Fortune* magazine stated that consumers are spending a record amount of food dollars, nearly 44%, away from home (Saporito, 1995). Therefore, food service restaurants are being forced into new ways of distributing to meet consumer demands and retain market share. An example of new distribution ideas in the quick service restaurant environment is non-traditional or alternative development. McDonald's has been a leader in this area, building smaller concept McDonald's stores inside of airports, malls, Wal-Marts and various convenience stores. Some other chains, such as Popeye's Chicken, have developed units inside of grocery stores and Wal-Marts (Anonymous, 1993), showing that quick service restaurants can be successful in supermarkets by bringing the product close to the consumer (Kramer, 1995). Franchisors have experienced incredible success with alternative development strategies. However, with these nontraditional locations comes concern from established franchisees about cannibalizing their sales and putting their units in danger of going under. Although many contracts offer limited to no territorial rights, encroachment issues are still a concern. Burger King, Blimpie, KFC, Taco Bell and Little Caesar's are among the chains that have had problems with franchisees who believe their sales have been diminished by alternative outlets such as kiosks and supermarket units (Prewitt, 1995). The franchisor perspective is that there is more market penetration that can be obtained, and if the chain doesn't take advantage of it then someone else will (Prewitt, 1995). Furthermore, they argue that more distribution units serve to increase customer recognition of the brand,

resulting in benefits for both the franchisor and franchisee. Many franchisees on the other hand, believe their sales are diminishing as a result of this encroachment and are filing breach of contract lawsuits against their parent companies.

Over the past decade, disputes between franchisees and franchisors have come into the spotlight as never before. International Dairy Queen, Little Caesar's, Domino's and a host of other franchisors have faced allegations of unfair competition, bullying, and antitrust violations. These complaints have reached the ears of the American public as well as the state and federal governments, leading to the consideration of federal and state level franchise legislation. Increased discussion and action regarding franchise laws are a new event emerging on the horizon of the hospitality industry, and offer both threats and opportunities to companies within the industry.

Franchising and the Franchise Relationship

The structure of the franchisor/franchisee relationship is based on the interdependence of both parties. The franchisor provides training, a brand name and marketing package, and a product. The franchisee provides the capital, employees, and management while at the same time financing the growth and expansion of the franchisor's product or service. Both parties may benefit from this arrangement: the franchisor benefits by reasonable assurance that one who invests such a large amount of time and money into the business will be dedicated to its success, the franchisee has access to resources and support he otherwise would not have as an independent business owner. The continuing franchisee/franchisor relationship has been identified as the most important and critical facet of the franchised business (Justice and Judd, 1986).

The most common legal problems that develop within this business relationship are those that deal with termination, non-renewal, disclosure and anti-trust issues. Often these issues are not easily resolved and result in a legal suit by one party and a countersuit by the other. Some of this can be attributed to the misunderstanding of the franchise contract, but much legal action is the result of perceived unfairness or illegal action by one of the parties. The Committee on Small Business of the U.S. House of Representatives released a report called Franchising in the U.S. Economy: Prospects and Problems (1990). This report reflected the committee's opinion that "a serious imbalance of power exists between franchisors and franchisees after the franchise agreement is initiated and throughout the ongoing relationship. Advantages of financial strength, access to information and to legal advice creates a gross disparity of bargaining power in favor of the franchisor that results in one-sided franchise agreements that are offered and generally accepted on a take-it-or-leave-it basis... inherent in practically every franchise agreement is the potential for significant abuse of the interests of franchisees".

Another problem is the evolution of franchisors -- many franchisees dealt directly with founders of various chains when they purchased a franchise, but many chains have been bought by large corporations, such as Pepsico. Traditionally, large corporations have a different way of doing things and wish to implement new and different policies that may adversely affect individual franchisees. For example, in today's volatile environment, franchisors are continually searching for new methods and strategies to increase their market share and ensure the long term viability of their company. This can include physical design changes to the stores, as well as the purchase and installation of

new technology or equipment to improve the competitive position of the business. Often, this requires a significant amount of additional capital on the part of the franchisee, whose only options may be to invest the additional capital or risk termination or non-renewal of the franchise (Taylor, 1992).

The Committee on Small Business of the U.S. House of Representatives declared (1990) franchisors have "...the power to intimidate and coerce behavior that may not be required or sanctioned under the franchise agreement...Franchisees face an equally difficult and inevitable of franchise renewal with the knowledge that any lack of cooperation...can also produce a challenge to renewal of the franchise..." The report views a franchisor's ability to contractually terminate or fail to renew a franchise as leverage (Kaufmann, 1990b). When the franchisee is up for renewal, many franchisors wish to update the original franchise agreement to reflect what new franchisees are signing. In the case of a 20 year contract up for renewal, the marketplace has likely changed dramatically, therefore the franchisors wish to implement a contract which reflects those changes. Established franchisees may believe they have a right to renew under the same terms although they may be a party to a limited term contract as a matter of law (Regulation of Franchising, 1994a). This can cause considerable friction with an established franchisee who wishes to maintain his original agreement. The House Committee continues: "...even when renewal is offered...the franchisee may have little option but to accept renewal on whatever terms the franchisor offers." Stephen Lynn, who has served as Chairman of the International Franchise Association, recognizes these problems. "There are some abuses going on by franchisors of the franchisees, either

intentionally or accidentally; there is a fear of potential abuses among franchisees; and corporate takeovers of franchised companies lead to increased communication breakdowns with the franchisees" (Whittemore, 1994).

Ideally, a franchise agreement considers the interests of both the franchisor and franchisee. However, the contracts are generally prepared by the franchisor and often place the franchisor in a more favorable position than the franchisee in both legal and financial areas, which sets the stage for potential conflict between the two parties.

One food service franchise agreement has been labeled one of the 'most progressive in the industry'. In an effort to make the system more attractive to potential franchisees (Caggiano, 1995), to remedy costly inefficiencies and to avoid arbitration, Taco John's decided to rework their franchise agreement. The company invited franchisees to assist with the process to ensure the agreement was palatable to both the franchisor and franchisees. Taco John's indicated that 85% of the franchisees have voluntarily signed the new documents, demonstrating their satisfaction with the new contract.

While many ethical franchisors will deal in good faith with franchisees, there are the others who will not. These franchisors are the ones who have helped propel franchising to the legal spotlight, evoking outcries from businessmen to not only the judicial system, but to their legislators for legal recourse.

Legal Issues and Franchise Regulation

While the franchising method has been successful, it has not come without a cost. Many well-known and relatively unknown franchisors face litigation from their franchisees at one time or another, with charges varying from unfair competition to unlawful termination and conspiracy to violate anti-trust laws, as well as price fixing and misrepresentation.

The Federal Trade Commission passed the Trade Regulation Rule of Franchising, referred to as the "Franchise Rule" in 1979 (Wall and Wieczorek, 1993; Purvin, 1994; Regulation of Franchising, 1994b). This requires that every franchisor which offers franchises in the U.S. must have a disclosure statement to offer potential franchisees prior to the sale of the franchise. The Uniform Franchise Offering Circular (UFOC) was developed under the jurisdiction of the North American Securities Administrators Association and requires 21 areas of disclosure (Table 3). Several states require registration of the UFOC for franchisors to operate within the state. While termination and antitrust issues are an area of significant legal problems for franchisors, the UFOC addresses disclosure, which is a problem area as well.

Disclosure

Disclosure laws were designed to prevent and minimize misrepresentation by franchisors to potential franchisees about the operation and requirements of the franchise. Federal and state governments have taken steps to reduce fraud potential by franchisors through disclosure requirements. Presented with evidences of unfair and deceptive sales practices by various franchisors, California, New Jersey, and Delaware took action at the

state level in the form of disclosure and registration laws for franchisors. Many states followed their lead, and in 1979 the government passed the Franchise Rule, which requires over 20 areas of disclosure which cover a host of issues, such as previous company ownership, business experience of the leaders, litigation and bankruptcy history, fees, supplier restrictions, territorial rights, franchisor obligations and much more.

Tying

Antitrust law covers abuses in the area of 'tying', which is defined as restrictions by franchisors on the source of supplies or services purchased by franchisees. Five laws regarding antitrust have been passed:

1) The Interstate Commerce Act of 1887
2) The Sherman Antitrust Act of 1890
3) The Clayton Act of 1914
4) The Federal Trade Commission Act of 1914
5) The Robinson-Patman Act of 1936

(Gleim and Jordan, 1995; Justis, 1989).

Table 3

The Uniform Franchise Offering Circular

The Disclosure Document

1. Background information
2. Business experience
3. Litigation history
4. Bankruptcy history
5. Initial fee
6. Ongoing fees
7. Initial investment
8. Required purchases
9. Franchisee obligations
10. Financing
11. Franchisor obligations
12. Territorial limitations
13. Trademarks
14. Patents and copyrights
15. Operation of business
16. Restrictions on goods and services sold by franchisee
17. Termination and other events
18. Public figures
19. Earnings claims
20. Statistics
21. Financial statements

Source: Law and Leading Attorneys, 1996

These laws seek to promote competition by prohibiting monopolization, conspiracy and attempts to monopolize, market allocations among competitors, price fixing, tying arrangements and unfair, deceptive practices that may decrease competition. The Sherman Act, the Clayton Act, the Robinson-Patman Act, and the Federal Trade Commission Act are considered the major statutes which concern franchising.

The Sherman Act prohibits agreements or conspiracies which restrain trade, and attempts to monopolize trade or commerce. There are a variety of elements necessary to violate this act. The first is that there must be two distinct products or elements, such that one may not be obtained unless the other is also purchased. Second, the tying product must possess sufficient economic power appreciably to restrain competition in the tied product market. Third, a substantial amount of interstate commerce must be affected by the franchise arrangement (Sherry, 1996). The basic tenets of this act have been virtually unchanged since its passage, however the penalties for violating its tenets have increased. The Clayton Act served to complement the Sherman Act by outlining restrictions on particular business practices, such as a prohibition on mergers that may substantially effect competition (Justis, 1989). Furthermore, sellers may not sell one product on the condition that the buyer buy some other product from the seller; and it is illegal for sellers to sell their products on the condition that the buyer stop dealing with the seller's competitors (Justis, 1989). The Robinson-Patman Act made it illegal for a seller to charge two different prices to two different buyers for the same product if that price difference may substantially reduce competition. The Federal Trade Commission outlined regulations regarding unfair advertising and deceptive practices. In addition to these

federal laws, many states have their own laws which must be investigated and followed by those who wish to franchise in the state.

Siegal v Chicken Delight, a classic food service case, illustrates how purchase requirements that are tied to obtaining a franchise may be in violation of antitrust laws (Sherry, 1996). Chicken Delight was sued by franchisees for injury resulting from alleged illegal restraints imposed upon them by the franchise contract (Siegal v Chicken Delight, 1974). Franchisees stated that they were forced to purchase a variety of cooking equipment, food items, and trade-marked packages exclusively from Chicken Delight. The court concluded that the tie-in arrangement required by Chicken Delight was indeed in violation of antitrust law, specifically, the Sherman Act.

Several franchisors, including Domino's and Little Caesar's have been accused of violating anti-trust laws. In the Domino's case, eleven franchisees and a franchisee association filed suit against Domino's, claiming the company has been controlling the market for required food and packaging supplies and that the Domino's distribution division charges five times the industry norm for food products (Anonymous, August 1995; Tannenbaum, 1995). Domino's denies the charges, and a federal judge dismissed the $140 million lawsuit on the grounds that the franchisees did not provide sufficient evidence that Domino's had indeed violated the law ("Judge tosses out", 1996).

Termination

Disputes over termination have been prominent in franchisor/franchisee arguments. Often a franchisee claims the termination provisions in the franchise contract are unfair, unclear, or have been inappropriately applied.

Representative LaFalce (D-NY) has proposed legislation in response to franchisee concerns, the Federal Fair Franchise Practices Act, the Franchise Disclosure and Consumer Protection Act, and the Federal Franchise Data and Public Information Act (Hogan, 1993). The Consumer Protection Act would increase the requirements on franchisor to disclose detailed information about their business to prospective investors and would give franchisees the right to sue franchisors for violations of federal franchising laws. The Federal Fair Franchise Practices Act relies on good-faith business conduct to promote fair dealing in the franchisor-franchisee relationship (Hogan, 1993). It guarantees franchisees freedom of association and prohibits requiring franchisees to purchase equipment and supplies from franchisors or their subsidiaries, terminating franchises without good cause and enforcing non-compete provisions after the franchising contract expires. The Federal Franchise Data And Public Information act would require the Commerce department to collect and publish data from the annual disclosure documents that franchisors file, and would require the Census Bureau to gather and analyze statistical data on franchises as part of its five-year business survey (Hogan, 1993). These proposals were initiated in 1991, however no action was taken by Congress. As of November 1996, the only bill at the federal level which would effect franchising is HR 1717, which encompasses the ideas in the previous bills introduced by

LaFalce, including proposals on data collection, registration and relationship provisions (Shay, 1996). This proposal received little if any attention during the 1996 legislative session.

Despite the antitrust laws and current franchise related laws, some groups such as the American Franchisee Association are pressing for additional legislation which they claim would serve to balance the scales between franchisors and franchisees. This association has drafted a model law that would established basic rules of practice for franchise relationships (Anonymous, 1996). This model law addresses many areas of franchisee concern, such as antitrust issues, grace periods for overdue payments, renewals, and franchise transfers. Another group, the American Association of Franchisees and Dealers (AAFD) proposes a self-regulatory approach to assuring fairness in franchise relationships (Anonymous, 1996). This group has designed the Fair Franchising Standards; franchisors who have met the criteria receive the AAFD's Fair Franchising Seal.

History of the Iowa Franchise Law

In 1992 Iowa adapted what is widely considered the most restrictive franchising legislation in the United States. Some believe the Iowa franchise law was enacted on the basis of one company's failure to adequately deal with franchisee concerns; what started as a dispute for territorial rights ended in a law which required significant changes in how franchisors were to conduct business in Iowa (King, 1993b; Peterson, 1993). The key areas addressed in the law are transfer rights, encroachment, termination, non-renewal,

jurisdiction of legal proceedings, sourcing, non-compete, repurchase of assets, and applicability (Iowa Code 523H, 1992).

Prior to PepsiCo's acquisition of KFC, then owner of KFC granted franchisees a mile and one half radius of territorial protection, agreed to open no new stores in areas of under 30,000 population, and also agreed to various rights concerning store transfers and independent sources of supply. This became known as the "1976 Agreement", an agreement which also granted the right to renew the agreement indefinitely. Pepsico became the new owner in 1986 and in 1989 began renegotiating the provisions of the 1976 Agreement, with little success. The company wished to discontinue territorial rights, impose a mandatory Louisville venue clause, require unit remodeling every seven years, and restricted the franchisors from searching for alternative suppliers. Pepsico wanted to implement these changes to provide enough flexibility to further build and to penetrate the market, however franchisees were concerned that new units would only cannibalize existing sales (Oleck, 1992). Furthermore the Louisville venue clause would make litigation so expensive that it would be impossible. Several KFC franchisees filed suit with the US District Court in Louisville, KY in 1989.

However, two Iowa businessmen who owned a combined total of 26 KFC stores across Iowa took their plight to the state legislature, and eventually won passage of a law which provided franchisees protection from encroachment, out of state venue clauses and a host of other things which had caused friction between franchisors and franchisees in the state. Since the passage of this law, various groups including the IFA and the ICRF have worked to have it repealed or reformed.

Specifics of the Iowa Legislation

State law usually includes elements of comprehensive disclosure to the franchisee, civil and criminal sanctions for noncompliance, and remedial rights to injured franchisees (Regulation of franchising, 1994b). One characteristic of the Iowa legislation that makes it so controversial is its attempt to regulate the on-going relationship between the franchisor and franchisee (Goodhard, 1992), rather than simply the initial sale disclosure requirements. The legislation addresses many aspects traditionally covered in a franchise contract, such as transfer rights, termination, non-renewal, encroachment, jurisdiction and remedies. The franchisor is prohibited from terminating or preventing the transfer of a franchise without 'due cause', which is defined as a legitimate business reason such as breach of contract. The 1992 version of the law has been changed somewhat as a result of successful lobbying and constitutional challenges in court. The legislature approved changes in May 1995, all of which will be addressed. Some franchises that deal with the sale of petroleum, real estate, construction equipment, or lawn and garden equipment were exempt from the law because of other industry specific legislation which governed their business dealings.

A "franchise" under the Iowa law includes an oral or written agreement, express or implied, covering the right to distribute goods or services under a marketing plan prescribed or suggested by the franchisor, plus payment of a fee to the franchisor or its affiliate, and allows the business to be "substantially associated" with the franchisor's trademark or other identifications (Brown, 1995; Iowa code 523H. 1, 3a1, 2). A general requirement of the law if that franchisors act in "good faith" in the performance and

enforcement of the franchise contract. "Good faith" is defined as "honesty in fact and the observance of reasoning commercial standards of fair dealing in the trade".

Applicability

The law was applicable to all new and existing franchises in the state of Iowa (Iowa code 523H.2, 1992). The biggest objection to the legislation as a whole was this retroactive effect, which nullified portions of previous contracts. It negated the parties' ability to contract freely as to certain terms considered critical by some franchisors (Goodhard, 1992). It was immediately challenged in court by a group of franchisors, with McDonald's leading the way (Allen, 1992; Goodhard, 1992; Oleck, 1993a, 1993b). The US District Court for the Southern District of Iowa ruled the retroactive effect of the law violated the contract clause of the US Constitution, which prohibits ex post facto laws or laws impairing obligations of contracts (Anonymous, 1994; King, 1993b; Oleck, 1993b; Peterson, 1993; US Constitution, 1787). The presiding judge stated that the clause 'materially changed rights to which parties agreed and for which they gave consideration' (Peterson, 1993; King, 1993b). The state appealed, however the 8th US Circuit Court of Appeals upheld the original decision (Bureau of National Affairs, 1995) and the US Supreme Court refused to hear the case on November 28, 1994 (Anonymous, 1995). Interestingly, although this portion of the law had been ruled unconstitutional, the legislature neglected to include this change in the 1995 amendments (Iowa code 523H.2, 1995).

Dispute Resolution/Venue

The legislature granted right of venue in Iowa rather than the franchisor's home state, regardless of previous contractual agreements that stated otherwise (Iowa code 523H.3, 1992). Many franchising contracts require that any legal action against the franchisor be initiated in the franchisor's home state, which can be very costly for a franchisee to seek any type of redress. The clause does permit the parties to agree to arbitration, mediation or other nonjudicial resolution to disputes. The right of venue in Iowa was retained in the 1995 amendments (Iowa code 523H.3, 1995).

Transfer of a franchise

The transfer requirements were designed to allow franchisees to transfer their business if they so desired, and allowed the franchisee to obtain the value of the franchise while not forcing the franchisor to compromise its own standards. The law requires the franchisor to allow the transfer to occur if the transferee satisfies the reasonable current qualifications of the franchisor for new franchisees; and to refrain from acting in an 'arbitrary or capricious' manner (Iowa code 523H.5, 1992). The franchisor has 60 days to approve the transferee and may impose a transfer fee or exercise the right of first refusal. The law further outlines conditions such as training, that the franchisor may require to permit the transfer. The law describes situations which are not considered transfers, such as the succession of ownership to an heir upon the death or disability of the franchisee, and prohibits the franchisor from interfering with the succession unless the successor does not meet current reasonable qualifications. Furthermore, the clause prohibits franchisors from interfering with public offerings, provided that the franchisee retain at

least 50 percent control. Furthermore, the franchisor may not enforce a covenant not to compete against a transferring franchisee although it may enforce covenants that prohibit the transferor's exploitation of the franchisor's trade secrets or intellectual property rights (Goodhard, 1992).

This clause was challenged in court as well; the 8th US Circuit Court of Appeals ruled in July 1994 that regulating circumstances under which franchisees could transfer units without franchisor consent was unconstitutional (Anonymous, 1994). The 1995 amendments (Iowa code 523H.5, 1995) granted franchisors more flexibility in transfer approvals. It allowed family members one year to meet franchisor requirements upon the death or disability of the franchisee. The legislature struck out the public offering clause altogether. Proposals for future changes include requiring a family member who has taken over the business to uphold franchisor standards during the period of their qualification as a franchisee (Wieczorek, 1995).

Encroachment

Many franchisees complain that the establishment of a new store near their vicinity decreases their sales and that they have no control over this except for a possible contractual right to first refusal. The law established a 'reasonable proximity' clause prohibiting franchisors to open stores within the shortest of a straight line three mile radius or a circular radius from an existing unit with a population of 30,000 or more for food establishment franchises (Iowa code 523H.6, 1992). No specific guidelines were imposed for other franchises. The parties must act in good faith in seeking mutually agreeable prices and terms. If a franchisor does not offer the right to first refusal, they

must compensate the existing franchisee for the market share diverted as determined by appraisers (King, 1995; Goodhard, 1992).

These guidelines were deemed unreasonable by many franchisors. The 1995 changes nullified the 3 mile/30,000 rule, replacing it with adverse impact guidelines (Iowa code 523H.6, 1995). If the gross sales of the existing unit decrease by over 5% within one year, the franchisee can assess damages against the franchisor unless the franchisee had first been offered the new outlet on similar terms as the existing one. The franchisee may not assess damages if they are not in compliance with then current requirements for new franchisees or the franchisor has a formal procedure for acting on encroachment claims and awarding compensation for lost profits. In any case, the franchisee has the burden of proving the amount of lost profits due to the new outlet.

A problem many franchisors have with this is determining exactly how sales of the current franchise were affected. Franchisors may argue that the sales of a franchisee could have been affected by a new competitor down the road rather than another store in the system. Another possibility is that there have been a series of poor management decisions at the existing franchise that has effected sales. The changes were welcomed by franchisors, but are still considered too restrictive, prompting many to continue working towards repeal of this section. Proposals for change include an adjustment to the impact guidelines from 5% to 10%. Many claim that five percent is too low to degrade profitability or the value of an existing unit; in some cases it could be as low as a few thousand dollars. Some critics charge that the impact could be concocted with 'creative

bookkeeping' and suggest that proximity and impact guidelines should be included in this clause (Wieczorek, 1995).

Termination

A franchisor may terminate a franchisee prior to the expiration of the contract only for good cause, that is, if the franchisee fails to comply with any material lawful requirement of the franchise agreement (Iowa code 523H.7, 1992). The law requires that the franchisor not act in a arbitrary or capricious manner when compared with other actions by the franchisor in similar circumstances; this burden of proof rests with the franchisee. A get well period of 30-90 days is required prior to termination, but need not exceed 30 days if the franchisee has not paid moneys required under the franchise agreement (Iowa code 523H.7, 1995). Proposals for change in the termination clause include reduced cure periods. The current cure periods force franchisors to deal with lengthy periods of noncompliance, which may be damaging to the entire franchise system (Wieczorek, 1995; Hess, 1995).

Non-renewal

Allegations of abuse regarding renewal has prompted specific legislation in an effort to protect franchisees from losing the business and their life savings. Many franchising contracts do provide the franchisee a right to renew, however, in many cases the option to offer renewal is strictly a decision of the franchisor. The franchisor may choose not to renew the contract and make the location a company owned store, with no regard for the investment or hard work of the franchisee (Purvin, 1994). This option on

the part of the franchisor is often clearly outlined in the contract, however the franchisee may suffer substantial loss if it is enforced.

Under the Iowa legislation, a franchisor may not refuse to renew unless they give at least six months notice and one of the following conditions exists as well:
a) good cause exists (as defined in the termination clause) b) the parties agree not to renew, or c) the franchisor is completely withdrawing from the area and waives the non-compete covenant (Iowa code 523H.8, 1992). The act does allow the franchisor to require the franchisee to meet the franchisor's current requirements and to agree to the current terms and fees for new franchisees (Iowa code 523H.8, 1995).

Noncompete

Franchisors are prohibited from enforcing non-compete clauses after a termination or non-renewal, with two exceptions: a) A business that relies on a substantially similar marketing program to that of the franchisor may be prohibited, and b) the franchisor must offer to purchase the assets of the franchised business for their fair market value as a going concern within 10 days before the expiration of the franchise contract (Iowa code 523H.11 and 523.5, 1992). The 1995 Amendments stated that a franchisee must meet the then current qualifications for new franchisees and may be required to sign a new contract. The changes also allowed the enforcement of non-compete provisions in the contract unless the franchisor was completely withdrawing from the area (Iowa code 523H.11, 1995).

Sourcing

A franchisor must allow the franchisee to obtain equipment, fixtures, supplies and services used in establishing and operating the franchise from sources of the franchisee's own choosing, provided that such good and services meet standards promulgated by the franchisor. This does not apply to reasonable quantities of inventory, goods or service the franchisor required the franchisee to obtain from the franchisor or its affiliate if such good or services are central to the franchised business and either a) are actually manufactured or produced by the franchisor or its affiliate or b) incorporate a trade secret owned by the franchisor or affiliate (Iowa code 523H.12, 1992). The 1995 Amendments left this section unchanged.

Repurchase of Assets

The initial law stated a "franchisee may engage in any lawful business after termination or non-renewal" unless they offer a program similar to the franchisor's or the franchisor offers within a period of time to buy the business (Iowa code 523H.11, 1992). This provision was unchanged in 1995, but seems to be in contradiction with non-renewal provisions in the clause addressing that issue. Currently, the law is applicable to any termination or non-renewal even when the franchisor has good cause and has met all legal requirements under the law. Suggestions have been made to reword the law to make it consistent by excepting franchisors who terminate or non-renew in accordance with the Iowa law (Wieczorek, 1995).

Private enforcement of the act is provided for damages caused by the violation, including costs and attorney fees, and subject to 'appropriate relief including injunctive and other equitable relief' (Brown, 1995).

The Fight to Repeal

Franchisors and many franchisees claimed the legislation was unnecessary and only served to add government red tape to a contract situation that has worked for decades between companies and franchise operators (Chase, 1991). While the primary opponents to the Iowa franchise legislation are franchisors, there are also a significant number of franchisees who wish to reform or repeal the legislation. This grassroots effort is the ICRF, whose members are from many different franchise systems, to include Pizza Ranch and McDonald's (Oleck, 1993a). Many Iowa business people have testified to the House Commerce Committee that they have been adversely affected by the law. One powerful force behind this group is the IFA, who has provided support and assistance in the fight to repeal the law.

The constitutionality of the law was immediately challenged by McDonald's Corporation and Holiday Inn. The franchisors argued that applying the law to existing or previously entered contracts law violated constitutional protection from retroactive laws. Additionally, they challenged clauses governing franchise transfers, territorial rights, non-renewal and termination (King, 1993b). The U.S. District Court judge ruled the retroactiveness of the law could not be enforced. The 8th U.S. Circuit Court of Appeals ruled on July 8, 1994 that the clause regulating circumstances under which franchisees

could transfer their units without franchisor consent was unconstitutional. These rulings required the law to be amended.

Others conclude that the law was aimed at the restaurant industry and was too broad to be applied to all franchise outfits evenly (Chase, 1991). Further, it ignored the fact that occasionally a franchisee is more powerful than its franchisor. For example, Bandag Inc. is a tire retreading outfit whose franchisees include Michelin and Bridgestone/Firestone, both of whom are larger and have more resources from which to draw. Some believe the best was to deal with companies who do not bargain in good faith is to apply specific laws to that particular industry since across-the-board regulations are difficult to apply to all industries (Chase, 1991).

How the Law Influenced Franchise Growth

Many companies changed their franchising strategy in Iowa. While several companies opened company stores, franchisors such as McDonald's, America's Favorite Chicken, KFC, Cost Cutters, and Blockbuster altered or forsook franchising as a method of expansion in Iowa (ICRF, 1995). The ICRF published a report in January 1995 claiming the law had a detrimental economic impact on the state because of the decrease in the amount of new franchises being granted in the state.

The report was based on a survey the group conducted in 1994 in an effort to estimate the economic impact the legislation had on the state. Their findings indicate that 133 companies reduced or halted expansion in Iowa, and will not resume expansion plans until the law is repealed or reformed. The ICRF estimates that 7,531 jobs were not created and $207 million in taxable revenue for the state was lost due to the changed

franchise expansion strategies. Furthermore, the study claims that the six states surrounding Iowa have had significant franchise growth. Proponents of the law say detrimental effects have been exaggerated and that statistics from the Iowa Department of Employment Services show that new restaurant jobs have been created, taxable revenue from businesses has increased and that 144 new franchises were granted in the state from 1992-1994 (Couch, 1996). These figures may be misleading, however, since the new restaurant jobs created included independent, company owned and franchisee stores. Furthermore, included in the 144 new franchises granted are some company owned stores and Wal-Mart stores, which do not grant franchisee stores at all.

Published research on the impact of franchise laws, specifically termination laws, indicate that termination laws increase the costs of franchising relative to company ownership and induce wealth transfer effects (Mandt, 1992; Brickley, Dark, & Weisbach, 1991). Brickley, et. al., concluded that termination laws reduce the amount of franchises relative to company owned stores in industries where individual units service transient, or non-repeat customers. Laws increase the cost of franchising by making quality control among franchises more expensive, therefore, franchisors shift marginal operations to company ownership. Further, the study of the California termination law showed that stockholders of franchisor incur significant wealth losses as wealth is transferred away from franchisors.

Summary

Certainly, the goal of any franchise law is to strike a balance between protecting the rights of franchisors to conduct business in a way they see fit and the rights of

franchisees to protect their investments. The 1990 House report (Committee on Small Business, 1990) concluded that "It is not enough for federal policy to simply assure that prospective franchisees are provided with adequate information about franchise opportunities; it must also assure that a fair balance is maintained between franchisors and franchisees throughout the franchise relationship."

Proponents of franchise legislation believe that franchisor/franchisee relations will advance once franchisees are empowered to negotiate the establishment of franchise practices (Bernstein, 1994). No action at the federal level has been taken, but at least 30 states have considered and rejected legislation similar to that which was passed in Iowa. The Iowa battle still rages, however some believe the law is workable. Franchisors have been accused of simply not wanting the law to work, and some franchisee organizations continue fighting to keep the law on the books (King, 1993a).

The nature of franchise relationships makes legislation difficult. Previously, legal minds relied on contract, anti-trust, employment, good faith laws and legal precedents to determine resolutions to franchise disputes. It is now becoming difficult to depend on traditional business laws to settle disputes since the franchisees are neither employees nor completely independent owners. Since franchise contracts have been built to last for many years, unforeseen trends further complicate franchise relationships (Taylor, 1992). In the 1970's problems arose with financing and constructing drive-through windows, which were necessary to remain competitive but put an unexpected financial burden on operators.

As franchising grows and changes within the competitive environment franchise law will grow as well. Lawyers working with both franchisors and franchisees have been required to develop expertise in many aspects of business law. Because of the variety of laws that can govern franchising, franchise law is emerging as a distinct body of rules which will continue to grow and evolve (Taylor, 1992).

No further changes to the law were passed during the 1996 legislative session, and the future of the Iowa franchise law is uncertain. What is certain, however, is that both sides will continue to work and lobby for passage of legislation they each consider favorable to their own side.

CHAPTER THREE

METHODOLOGY

Introduction

The purpose of this chapter is to describe and justify the methodologies selected to conduct this exploratory study on the impact of the 1992 Iowa Franchise Act and its 1995 Amendments.

Research Questions

The following research questions were defined for the study:

1) What impact have the 1992 Iowa Franchise Act and its 1995 Amendments had on the decisions of restaurant companies regarding unit expansion through granting new franchises or building company owned stores in Iowa?

2) What specific clauses of the law were the most influential in this decision making?

3) How were franchisors impacted in terms of litigation with franchisees as a direct result of the Iowa laws?

4) What specific clauses of the law were the most influential in the level of litigation with franchisees?

5) How were franchisors impacted in terms of operational changes as a result of the law?

Research Design

The purpose of this study is to examine the relationship between the passage of the Iowa Franchise Law and changes in restaurant franchisor expansion strategy within the state. Franchisors were asked to examine changes in granting new franchises within the state of Iowa in context of the new law. The literature on the subject indicates that

there has been a decrease in franchising as a result of the law, however further investigation is needed to verify this assertion.

The survey method was chosen as the most practical and direct toward meeting the objectives of the study. Surveys generally provide quick, inexpensive, efficient, and accurate means of assessing information about the population (Zikmund, 1997). While this method may lend itself to a high degree of generalizability within the food service industry, the author recognizes that realism of context as well as control over the behavioral variables experience a degree of loss (Runkel & McGrath, 1972). Disadvantages include non-response error, response bias, and administrative errors (Zikmund, 1997), however, in light of the research problem in question as well as the detailed queries, the survey method was deemed most suitable. Generalizability does not extend to other franchise businesses affected by the law such as hotels, dating services, laundry and dry cleaning, printing services and any other non-food service business.

Sample Selection and Data Collection Method

The population for this study consisted of all U.S. based restaurant companies who franchise their units. Unfortunately, there is no exhaustive list of these companies, therefore the sample was drawn from a sampling frame of companies listed in the *1996 IFA Franchise Opportunities Guide*, the *Nation's Restaurant News Top 200* (Anonymous, August 7, 1995; Martin, 1995), and *Restaurants & Institutions Top 400* (Anonymous, July 1995). Not all the companies listed in *Nation's Restaurant News* or *Restaurants & Institutions* franchised their units, so further investigation by way of

telephone calls, internet searches, and article searches was conducted in an attempt to ensure that only franchisors were included in the sample.

A survey based on the study's objectives and research hypotheses was developed through consultation with an attorney, a food services franchisor, academic experts and franchise experts. These individuals were consulted in an attempt to ensure the validity of the scale, that is, to ensure that it measures what it is intended to measure. Because no academic research on the impact of franchise laws on expansion strategy has been published, there was no literature base to consult in the development of the survey instrument. The survey was pre-tested on select university faculty and a restaurant franchisor. It consisted of a self-administered questionnaire which was sent through the mail to potential participants. The survey was accompanied with a return envelope and cover letter requesting the recipient to respond and explaining the purpose and importance of the study (Appendix A). Follow up surveys and letters (Appendix B) were sent in an effort to increase the response rate. Attached to the survey was a detailed explanation of the 1992 Iowa Franchise Law and the 1995 Amendments (Appendix C).

The survey itself was developed after a thorough review of related literature. The questionnaire focused on nine clauses of the law: applicability, dispute resolution, transfer, encroachment, non-renewal, non-compete, repurchase of assets, termination, and sourcing. These clauses were identified as the most controversial by the court battles surrounding them, the literature in the trade magazines and legal journals, and through consultation with the IFA and a restaurant franchisor.

The survey instrument was divided into three sections. The first is concerned with company demographics, such as how long the company has been franchising in the US, how many units are franchised and company owned in the US, and how many are franchised and company owned within the state of Iowa.

The second section deals with the 1992 Iowa Franchise Law, its impact and company response. Questions regarding changes in expansion strategy for franchised and company owned stores were presented, as were queries about how the law impacted the company in terms of litigation with franchisees and operational changes. Respondents were asked to indicate which clauses of the law were influential in changing their expansion strategy, if they had indeed done so.

The third and final section of the survey focused on the same issue as did the second section, however respondents were asked to consider the 1995 Amendments to the 1992 law when formulating their responses.

Pilot Study

A pilot study of 15 food service franchisors was conducted. The pilot study is a small scale exploratory research technique that uses analysis but does not apply rigorous standards to the analysis (Zikmund, 1997). The primary purpose of the pilot study was to determine approximate response rates and times, and more importantly to ensure the questions were clear and unambiguous. Of the 15 surveyed, three responded, two of which provided usable surveys, yielding an overall response rate of 20%. Those who returned the pilot surveys suggested no improvements, therefore the survey instrument remained unchanged.

Survey Instrument

Each research question, related hypotheses and survey questions are presented in Table 4.

<u>Research Question 1</u>

What impact, if any, have the 1992 Iowa Franchise Act and its 1995 Amendments had on the decisions of restaurant companies regarding unit expansion through granting new franchises or building company owned stores in Iowa?

Questions 4 and 4a on the survey requested information about the changes in overall expansion strategy as a direct result of the 1992 law, while questions 10 and 10a addressed changes in response to the 1995 amendments. More specific information about changing the rate of new franchisee store development and company owned store development in regards to the 1992 law was solicited by questions 5 and 6; the same issues with the 1995 amendments were addressed by questions 11 and 12.

Confidence intervals will be constructed for questions 4 and 10 to test the related hypotheses. Usually a test of proportions is done to determine if p is equal to zero or greater than zero. However, if even one positive response is made, than p is greater than zero. It is therefore more logical statistically to compute confidence intervals.

Research Question 2

What specific clauses of the law were the most influential in this decision making?

Question 5a asked respondents who had changed their franchisee expansion strategy as a result of the 1992 law to indicate which clauses of the law were the driving forces behind those changes. Question 10a solicits similar information in regards to the 1995 amendments.

The recommended test to analyze this ordinal data is the Kruskal Wallis nonparametric test, which would determine if there is equal distribution of responses across the independent groups. In order to perform with test with an adequate degree of power, a minimum of 30 participants must respond to the survey questions listed above.

Research Question 3

How were franchisors impacted in terms of litigation with franchisees as a direct result of the Iowa laws?

The impact of the 1992 law on litigation with franchisees was measured by survey questions 7, 8, and 9, which asked if the company had been involved with or relieved of litigation with franchisees as a result of the law. Similar queries were made with questions 13, 14, and 15 in regards to the 1995 Amendments.

Confidence intervals will be constructed for questions 7, 8, 13, and 14 to test the related hypotheses. Usually a test of proportions is done to determine if p is equal to zero or greater than zero. However, if even one positive response is made, than p is greater than zero. It is therefore more logical statistically to compute confidence intervals.

Research Question 4

What specific clauses of the law were the most influential in the level of litigation with franchisees?

Respondents were asked to rate how each separate clause of the law influenced the level of increased or decreased litigation with franchisees in questions 7a and 8a for the 1992 law and questions 13a and 14a for the 1995 Amendments.

The recommended test to analyze this ordinal data is the Kruskal Wallis nonparametric test, which would determine if there is equal distribution of responses across the independent groups. In order to perform with test with an adequate degree of power, a minimum of 30 participants must respond to the survey questions listed above.

Research Question 5

How were franchisors impacted in terms of operational changes as a result of the law?

Questions 9 and 15 ask franchisors if operational changes were made as a result of the 1992 and 1995 laws. Confidence intervals will be constructed for these questions to test the related hypotheses. Usually a test of proportions is done to determine if p is equal to zero or greater than zero. However, if even one positive response is made, than p is greater than zero. It is therefore more logical statistically to compute confidence intervals. Questions 9a and 15a query participants as to why operational changes were necessary.

Variables

The independent variables for this study are the Iowa Franchise Act and the 1995 Amendments. The dependent variables are a) changes in expansion strategy, b) granting of new franchises, c) establishment of company owned stores, d) amount of litigation with franchisees, and e) operational changes.

Hypotheses

1. The 1992 Iowa Franchise Act, its impact, and company response

1a. Ho: There were no changes to restaurant franchisor expansion strategies in Iowa as a result of the passage of the 1992 Iowa Franchise Act.

1b. Ho: There were no changes to the level of new franchises granted in Iowa as a result of the passage of the 1992 Iowa Franchise Act.

1c. Ho: There were no changes to the level of new company stores established in Iowa as a result of the passage of the 1992 Iowa Franchise Act.

1d. Ho: No one clause of the law was perceived to be more influential than any other in franchising decision.

1e. Ho: The passage of the 1992 Iowa Franchise Act had no impact on the amount of litigation with franchisees in which restaurant franchisors became involved.

1f. Ho: No one clause of the 1992 law was perceived to be more influential in the level litigation than any other.

1g. Ho: The passage of the 1992 Iowa Franchise Act had no impact on the operational aspects (competitive methods, production and selling methods) of companies who franchise in Iowa.

2. The 1995 Amendments, their impact, company response

2a. Ho: There were no changes to restaurant franchisor expansion strategies in Iowa as a result of the passage of the 1995 Amendments.

2b. Ho: There were no changes to the level of new franchises granted in Iowa as a result of the passage of the 1995 Amendments.

2c. Ho: There were no changes to the level of new company stores established in Iowa as a result of the passage of the 1995 Amendments.

2d. Ho: No one clause of the law was perceived to be more influential than any other in franchising decision.

2e. Ho: The passage of the 1995 Amendments had no impact on the amount of litigation with franchisees in which restaurant franchisors became involved.

2f. Ho: No one clause of the 1995 Amendments was perceived to be more influential in the level of litigation than any other.

2g. Ho: The passage of the 1995 Amendments had no impact on the operational aspects (competitive methods, production and selling methods) of companies who franchise in Iowa.

These hypotheses were constructed to test whether the passage of the 1992 Iowa Franchise Act and its 1995 Amendments had any impact on the rate of new franchises being granted in Iowa, to determine if the requirements of one clause were any more

influential than the others, and to determine the impact in terms of litigation and operational changes to restaurant franchising companies.

Summary

An overview of research methodology is presented in this chapter, as well as a conceptual overview of the research. This chapter included a detailed discussion of the development of the survey instrument, the sample population used for the study, and the research questions and hypotheses. The results of the statistical analysis, conclusions and implications will be presented in the following chapters.

Table 4

Research Questions, Hypothesis, and Survey Questions

Research Question	Research Hypothesis *	Survey Question
1. Impact of 1992 and 1995 laws on unit expansion and expansion strategy	1a - Expansion strategy	4, 4a
	1b - Franchised units	5
	1c - Company units	6
	2a - Expansion strategy	10, 10a
	2b - Franchised units	11
	2c - Company units	12
2. What clauses were the most influential in expansion strategy decisions	1d - Influential clauses	5a
	2d - Influential clauses	11a
3. Impact of law on litigation	1e - Level of litigation	7, 8
	2e - Level of litigation	13, 14
4. What clauses were the most influential in the level of litigation	1f - Influential clauses	7a, 8a
	2f - Influential clauses	13a, 14a
5. Impact of law on operations	1g - Impact on operations	9, 9a
	2g - Impact on operations	15, 15a

* All research hypotheses preceded by "1" refer to the 1992 law; all hypotheses preceded by "2" refer to the 1995 amendments.

CHAPTER FOUR

RESULTS AND ANALYSIS

Introduction

The preceding chapters presented the research questions and data collection methodology of the study. The purpose of this chapter is to present an analysis of the data collected using the survey instrument. The results reported in this chapter will be the basis for deriving conclusions and recommendations, which will be presented in the next and final chapter. The results are grouped in sections based on the stated objectives and research questions.

Response

In January, 1997 questionnaires were mailed to 203 US restaurant franchisors. This number includes all the restaurant franchisors listed in *Nation's Restaurant News Top 200* as well as many listed in *Restaurants & Institutions Top 400.* In February a follow up survey was mailed, and in March 1997, follow up letters were sent to all potential participants. Three surveys were returned marked "address unknown - return to sender", bringing the total number of potential participants to 200. By the beginning of April, 55 companies had responded, yielding a response rate of 27.5%. Of these, three no longer franchise their units or do not franchise in the United States, which excludes them from the study, bringing the total number of potential participants to 197. Sixteen elected not to participate; of those, 11 did not participate because they do not franchise in Iowa and have no plans to do so in the near future. This left a total of 36 completed questionnaires, yielding an effective response rate of 18.27% (Table 5).

Table 5

Response Rates

Category	Number	Percentage of Total
Surveys mailed out	203	100.00%
Return to sender	3	1.50%
Do not franchise	3	1.50%
Adjusted potential participants	*197*	
Category	Number	*Adjusted percentage*
No response	145	73.61%
Not participating	16	8.12%
Completed surveys	36	**18.27%**

Demographic Information

The first three questions on the survey request demographic information in regards to how long the company has been franchising in the US, how many company owned units, and how many franchised units are operational in the US and in the state of Iowa (Tables 6 and 7).

The first question on the survey asks how many years the company has been franchising in the United States. Of the 36 respondents, 35 answered this question. The mean number of years was 22.7 with a standard deviation of 12.5. The maximum number of years a company had offered franchises within the US was 57 and the minimum number of years was one. The median was calculated at 20 years, which is very close to the mean of 22.7 years.

The second survey question consisted of three parts: a) how many company owned units were established in the US, b) how many franchised units were established in the US, and c) how many total units were established in the US.

Of the respondents, 35 of the 36 answered the question regarding the number of US company owned stores. The mean number of company owned units in the US for the respondents was 193 with a standard deviation of 463, which is more than twice the mean. The maximum number of company owned units was 2500, the minimum was 0, and the median was 26. The distribution curve was not normal. This was not necessarily unexpected since there are many different types of restaurants franchise and each have a different number of franchised and company owned units.

Thirty-five of the 36 respondents provided the number of US franchised stores. The mean number of franchised units within the US was 609 with a standard deviation of 1980. The standard deviation is again over twice the mean, which indicates a distribution which is not normal. The maximum number of US franchised units was 11500, the minimum was 0 and the median was 98, with the interquartile range starting at 55 and ending at 247. Franchised units outnumbered company owned units by a ratio of 3.15 to 1 in this survey.

All 36 companies provided information on the total number of US units. The mean number was 783, with a standard deviation of 2077. The number of units ranged from a minimum of 36 to a maximum of 11500, with 187 being both the median and the mode. This is a very wide range of units, however only seven (19.4%) of the companies had over 500 units, and five of the seven (14.3% of the total) had over 1000 units. The data for US companies as a whole were quite variable, as evidenced by the standard deviations being over twice the mean for the company owned, franchised, and total number of company units.

The third demographic question asked how many of the following units were established in Iowa in 1996: a) company owned, b) franchised, and c) total. The mean number of company owned units in Iowa in 1996 was 0.59 with a standard deviation of 2.35. The maximum number of units was 13, while the minimum number and the median were both 0. The mode was 0 as well, indicating a non-normal distribution in regards to the number of company owned stores in the state.

The mean number of Iowa franchised units in 1996 was 1.88 with a standard deviation of 7.15. The maximum value was 40, however both the minimum value and the median were 0. Again, this indicates that there is not a normal distribution of the data. The ratio of franchised to company owned units in Iowa was 3.2 to 1 for this survey.

Finally, the total number of company owned and franchised units in the state of Iowa in 1996 ranged from 0 to 40, with a mean of 2.47 and a standard deviation of 7.53. The large standard deviation is explained by the wide range of number of units, which varied from 0 to 40.

Table 6

Descriptive Statistics for Number of Units

Category	Mean	Standard Deviation
Number of Years Franchising in US	22.66	12.45
US Company Owned Units	193.23	463.11
US Franchised Units	609.17	1980.50
US Total Units	783.25	2076.66
Iowa Company Owned Units	0.58	2.35
Iowa Franchised Units	1.88	7.15
Iowa Total Units	2.47	7.53

Table 7

Frequency Distributions for Descriptive Statistics

Years Franchising

Years	Frequency	Percent *
1 - 10	5	13.9%
11 - 20	13	36.1%
21 - 30	8	22.2%
31 - 40	6	16.7%
41 - 50	2	5.7%
Over 50	1	2.1%
Missing	1	2.1%

US Company Owned Units

Number	Frequency	Percent *
0 - 100	24	66.7%
101 - 200	5	13.9%
201 - 500	2	5.6%
Over 500	4	11.1%
Missing	1	2.1%

US Franchised Units

Number	Frequency	Percent *
0 - 100	19	52.8%
101 - 200	5	13.9%
201 - 300	6	16.7%
Over 300	5	13.9%
Missing	1	2.1%

Table 7 Continued

US Total Units

Number	Frequency	Percent *
0 - 100	5	13.9%
101 - 200	14	38.9%
201 - 300	7	19.4%
301 - 400	2	5.6%
401 - 500	1	2.1%
501 - 1000	2	5.6%
Over 1000	5	13.9%
Missing	0	0%

Iowa Company Owned Units

Number	Frequency	Percent *
0 - 10	33	91.7%
Over 10	1	2.1%
Missing	2	5.6%

Iowa Franchised Units

Number	Frequency	Percent *
0 - 10	33	91.7%
Over 10	1	2.1%
Missing	2	5.6%

Iowa Total Units

Number	Frequency	Percent *
0 - 10	31	86.1%
11 - 20	2	5.6%
Over 20	1	2.1%
Missing	2	5.6%

* Percent may not add up to 100% due to rounding.

Hypothesis Testing

<u>Research Question 1</u>

What impact, if any, have the 1992 Iowa Franchise Act and its 1995 Amendments had on the decisions of restaurant companies regarding unit expansion through granting new franchises or building company owned stores in Iowa?

Survey question 4 asked respondents if the company had changed its expansion strategy as a result of the 1992 Iowa law. Of the 35 participants who responded to this question, 28.6% answered 'yes', that they had changed their expansion strategy. One company expressed dissatisfaction with the law, but indicated that they felt they had no choice but to continue their current expansion plans because their corporate headquarters are located in Iowa.

A 95% confidence interval was calculated for the true proportion of companies that changed their expansion strategy in Iowa as a direct result of the law. The lower 95% confidence limit is 13.61 and the upper limit is 43.54. Since zero is not contained in the interval, the null hypothesis is rejected (1a) at the 0.05 level.

Question 4a made use of a randomized complete block design, where each respondent is treated like a block and each question is a treatment, however in a departure from traditional design, the responses take on the values of 0, which indicates the respondent did not circle the response, or 1 which indicates the respondent did circle that particular response. This scenario fits Cochran's Q test, which follows an asymptotic chi square distribution with (t-1) degrees of freedom where t is the number of treatments. The Q-value was 6.6 with 3 degrees of freedom, and the p-value was 0.086, which is not

significant at the 0.05 value. However, this figure is closer to significance than it is to nonsignificance. If the response rate had been higher and yielded more data, significance may have been found in this particular question. The addition of one observation during the course of the analysis took the p-value from 0.23 to 0.08. However, since statistical significance was not found, which would have indicated a difference in treatments, multiple comparisons could not be conducted to characterize differences.

Speaking strictly from a descriptive standpoint, five respondents indicated that they had changed the rate of new unit development in the state, three indicated that they are participating in the formation of alliances as a direct result of the law, and one company has entered into dual branding. One company commented that they would open neither company owned nor franchised units in Iowa because of the legislation, while another commented that they were very cautious about market development in Iowa. Another franchisor stated that if they had planned expansion in Iowa prior to the law, they would have stopped, but at the passage of the law they had no plans to expand into Iowa. The same company currently has no long term planned franchise expansion into Iowa because of the law.

Question 5 asked if the company had decided to change the rate of granting new franchisee stores after the 1992 law was enacted. A chi-square goodness of fit test was conducted to determine if all seven responses categories were equally likely, and it was found that they were not (Table 8). The chi-square value was 47.99 with 6 degrees of freedom, which yields a p-value of less than 0.0001. It appears that companies did change the rate at which new franchises were granted after the 1992 law was enacted.

Specifically, 54.3% of companies surveyed did not franchise in Iowa in 1992, and 22.9% of those surveyed completely halted granting new franchise stores. Of those who cited restrictions, one company stated that they would not endeavor to franchise in Iowa without a specific unsolicited franchisor lead. One franchisor commented that they were very concerned about the law and were not advertising nor were they accepting inquiries from Iowa. Another stated that they had established specific criteria regarding "existing franchisee expansion via individual qualification and site qualification as it relates to the Iowa law".

A problem with the chi-square goodness of fit test in this context is that the expected cell counts were 4.71; just short of the recommended 5 per cell. However, given the closeness of the number to five as well as the raw data, the author believes the test has provided a satisfactory picture of the reaction to the law. Over half of the respondents did not franchise at all in Iowa, but for those who did, 28.6% indicated that they halted or restricted franchising in the state as a direct result of the law, while only 14.3% indicated they continued to grant franchises with no change. This leads to a rejection of the null hypothesis (1b).

Survey question 6 asked if companies had changed the rate at which they established company owned stores in Iowa after the passage of the law. Again, a chi-square goodness of fit test was conducted (Table 9). The chi-square value was 56.06 with six degrees of freedom, which yielded a p-value of less than 0.0001. The expected value per cell was 4.71, just shy of the recommended number of 5. While 60.6% of the companies indicated that they did not have company owned stores in Iowa in 1992,

24.2% indicated that they continued to establish company owned stores without change. Six percent completely halted company store expansion in the state, while 9% increased the number of company owned stores. A total of 15% of the companies changed the rate at which they established company owned stores, however 24% did not, which leads to a failure to reject the null hypothesis (1c)

Survey question 10 asked respondents if the company had changed its expansion strategy as a result of the 1995 Amendments to the law. Of the respondents, 22.2% answered 'yes'. A 95% confidence interval was calculated for the true proportion of companies that changed their expansion strategies as a result of the 1995 Amendments. The lower 95% confidence limit is 8.64 and the upper is 35.80, which leads to a rejection of the null hypothesis (2a) since zero is not contained in the interval.

Question 10a asks respondents how changes to expansion strategy were implemented as a direct result of the 1995 Amendments. The situation for statistical analysis here is the same as discussed above in question 4a. The Q-value is 5.08, with a p-value at three degrees of freedom of 0.16. Though this value is not significant at the 0.05 level, it is closer to significance than to nonsignificance, again leading the researcher to believe that more data may have provided statistical significance.

Three of the companies indicated that they had changed the level of new unit development in the state, one is now participating in the formation of alliances as a result of the 1995 amendments, and one is participating in dual branding. Of the respondents, five annotated the 'other' category. Comments provided ranged from a willingness to franchise now that reforms had passed, to a refusal to franchise until further reforms or a

repeal of the law was passed. Two companies indicated an intention to "wait and see" before resuming franchising in Iowa.

Question 11 requested information in regards to companies changing the rate of granting new franchisee stores in Iowa after the 1995 Amendments passed. A chi-square goodness of fit test was conducted (Table 10), however this time the expected cell counts were 5.14, surpassing the recommended number of 5. Over nineteen percent indicated that they continued granting new franchisee stores without change, while 72.2% did not franchise in Iowa in 1995. The remaining 8.3% were evenly split between completely halting new franchisee stores, restricting the number of stores and the category of 'other'. The fact that the percentage of those who continued granting new franchisee stores without change (19.4%) was greater than the total of those who change the rate at which they granted new stores (5.6%) or those who took a 'wait and see attitude' (2.8%) leads to a failure to reject the null hypothesis (2b).

The last and final question in regards to research question number one was survey question number 12, which queried participants about the change in establishing company owned stores. Again, a chi-square goodness of fit test was conducted and a majority (65.6%) indicated that they did not have company owned stores in Iowa in 1995. However, 28.1% indicated that they continued establishing company owned stores with no change, and 3.1% established a new concept which was not being franchised (Table 11). These percentages lead to a failure to reject the null hypothesis (2c).

It may seem contradictory that a significant number of companies claimed to have changed their expansion strategy as a result of the 1995 amendments, yet no significant

changes were found in the establishment of new franchised or company owned stores. This apparent contradiction resulted from the non-response of four participants on question 12. Because of the small sample size, the question non-response of four participants, which equals 11% of the total sample, can have a substantial impact on whether or not statistical significance is found. Had these four companies responded to the related questions, it is likely that statistical significance may have been found.

Table 8

Chi-Square Goodness of Fit

Question 5: *Did the company decide to change the rate at which it granted new franchisee stores in Iowa after the 1992 Iowa Franchise Law was implemented?*

Chi-Square Ho: Each of the seven responses are equally likely to be chosen

* Response	A	B	C	D	E	F	G
Frequency	8	2	0	0	5	19	1
Percent	22.86	5.71	0	0	14.29	54.29	2.86

Conclusion: Reject Ho; each of the seven responses are not equally likely to be chosen

Chi-Square Observed value = 47.99

P-value < 0.0001 (significant at the 0.05 level)

* Key to responses:

A = Halted granting new franchisee stores
B = Restricted new franchisee stores
C = Increased level of new franchisee stores
D = Began granting new franchisee stores for the first time
E = Continued granting franchisee stores with no change
F = Did not franchise in Iowa in 1992
G = Other

Table 9

Chi-Square Goodness of Fit

Question 6: *Did the company decide to change the rate at which it established company owned stores in Iowa after the 1992 Iowa Franchise Law was implemented?*

Chi-Square Ho: Each of the seven responses are equally likely to be chosen

* Response	A	B	C	D	E	F	G
Frequency	2	0	3	0	8	20	0
Percent	6.06	0	9.09	0	24.24	60.60	0

Conclusion: Reject Ho; each of the seven responses are not equally likely to be chosen

Chi-Square Observed value = 56.06

P-value < 0.0001 (significant at the 0.05 level)

* Key to responses:

A = Halted company owned stores
B = Restricted company owned stores
C = Increased company owned stores
D = Began establishing company owned stores for the first time
E = Continued establishing company owned stores with no change
F = Did not have company stores in Iowa in 1992
G = Other

Table 10

Chi-Square Goodness of Fit

Question 11: *Did the company decide to change the rate at which it granted new franchisee stores in Iowa after the 1995 Amendments were implemented?*

Chi-Square Ho: Each of the seven responses are equally likely to be chosen

* Response	A	B	C	D	E	F	G
Frequency	1	1	0	0	7	26	1
Percent	2.78	2.78	0	0	19.44	72.22	2.78

Conclusion: Reject Ho; each of the seven responses are not equally likely to be chosen

Chi-Square Observed value = 96.74

P-value < 0.0001

* Key to responses:

A = Halted granting new franchisee stores
B = Restricted new franchisee stores
C = Increased level of new franchisee stores
D = Began granting new franchisee stores for the first time
E = Continued granting franchisee stores with no change
F = Did not franchise in Iowa in 1995
G = Other

Table 11

Chi-Square Goodness of Fit

Question 12: *Did the company decide to change the rate at which it established company owned stores in Iowa after the implementation of the 1995 Amendments?*

Chi-Square Ho: Each of the seven responses are equally likely to be chosen

* Response	A	B	C	D	E	F	G
Frequency	0	0	1	0	9	21	1
Percent	0	0	3.13	0	28.13	65.63	3.13

Conclusion: Reject Ho; each of the seven responses are not equally likely to be chosen

Chi-Square Observed value = 70.87

P-value < 0.0001

* Key to responses:

A = Halted company owned stores
B = Restricted company owned stores
C = Increased company owned stores
D = Began establishing company owned stores for the first time
E = Continued establishing company owned stores with no change
F = Did not have company stores in Iowa in 1995
G = Other

Research Question 2

What specific clauses of the law were the most influential in this decision making?

Question 5a asked which clauses of the 1992 law were most influential in driving changes to granting franchisee stores in Iowa after implementation of the law. The data were collected on a Likert-type scale, and the author intended to do the Kruskal Wallis nonparametric test. Unfortunately, only eight respondents completed this section of the questionnaire; a significantly larger number of responses is needed, preferably a total of 30 to 40 to proceed with this nonparametric test. In light of this problem, a discussion on the frequency of responses and practical importance is the best available recourse.

A table providing the scores and averages is presented to provide the reader with an idea of the general attitudes about each clause (Table 12), however a true mean cannot be calculated due to the ordinal nature of the data. Therefore, for the purposes of this discussion the author has collapsed the data into the following categories: a) 1-3 = disagree, b) 4 = neutral, and c) 5-7 = agree (Table 13). The encroachment, non-renewal and non-compete clauses were cited as the most influential in decisions to change the rate at which new franchisee stores were granted after the passage of the 1992 law. Applicability, dispute resolution, transfer, repurchase of assets and termination clauses trailed closely behind those previously mentioned. All respondents in this category agreed that the non-compete, repurchase of assets, and sourcing clauses played a role in their decision to change franchisee expansion within the state.

Question 11a asked which of the clauses in the 1995 Amendments were influential in changes made in granting new franchisee stores in Iowa. However, no company

participating in the survey halted granting new franchisee stores after the 1995 Amendments, although some continued to deny granting new franchisee units in accordance with their decision as a result of the passage of the 1992 law. Therefore, hypothesis 2d could not be tested.

Table 12

Response Distribution for Question 5a
Influential clauses in expansion strategy decisions

1 = Strongly Disagree   7 = Strongly Agree

* Clauses:	A	B	C	D	E	F	G	H	I
Respondent:									
1	7	7	7	7	7	7	7	7	7
2	1	3	2	1	2	4	4	2	4
3	5	5	6	6	6	6	7	7	4
4	4	4	7	7	7	7	4	7	4
5	5	5	5	4	5	5	5	5	5
6	7	7	1	7	5	7	7	1	7
7	4		7	7	7	7	6	7	6
8	7	5	4	7	4	4	4	4	4
Mean:	5	5.14	4.87	5.75	5.37	5.87	5.5	5	5.1

* Key to Clauses:

A = Applicability
B = Dispute Resolution
C = Transfer
D = Encroachment
E = Non-renewal
F = Noncompete
G = Repurchase of Assets
H = Termination
I = Sourcing

Table 13

Collapsed Data for Question 5a

Frequency of Responses for each Category

*Clause	Disagree 1-3	Neutral 4	Agree 5-7
A	1	2	5
B	1	1	5
C	2	1	5
D	1	1	6
E	1	1	6
F	0	2	6
G	0	3	5
H	2	1	5
I	0	4	4

* Key to Clauses:

A = Applicability
B = Dispute Resolution
C = Transfer
D = Encroachment
E = Non-renewal
F = Noncompete
G = Repurchase of Assets
H = Termination
I = Sourcing

Research Question 3

How were franchisors impacted in terms of litigation with franchisees as a direct result of the Iowa laws?

Question 7 asked if the company had been involved in litigation with franchisees as a direct result of the 1992 law. Of the 36 respondents, 2.77% (one company) answered in the affirmative. A 95% confidence interval was calculated for the true proportion of companies that were involved with this litigation. The lower limit is 0 and the upper limit is 8.15%, which leads to a failure to reject the null hypothesis (1e) at the 0.05 level since zero is contained in the interval.

For question 8, 100% of the companies surveyed indicated that they had not experienced relief from litigation with franchisees as a direct result of the 1992 law. Since the responses took on a constant value, a variance could not be calculated. Of course this lack of variance also means that no hypotheses test could be performed, nor confidence intervals calculated. However from a practical standpoint, in addition to the results from question 7, one can say that the probability of experiencing relief from litigation with franchisees is very low. There is strong evidence to support the null hypothesis (1e).

Questions 13 and 14 asked respondents if they had experienced an increase in litigation with franchisees or relief from litigation with franchisees respectively, as a direct result of the 1995 Amendments. One hundred percent of participants answered 'no' to both questions. Again, the constant value of responses prevented variances from being calculated and hypothesis tests being conducted. However we can safely state that

the probability of increased involvement with litigation and relief from litigation as a direct result of the 1995 Amendments is extremely low, which provides strong evidence in support of the null hypothesis (2e).

Research Question 4

What specific clauses of the law were the most influential in the level of litigation with franchisees?

Questions 7a and 8a inquired about which clauses of the law were the most influential in the level of litigation with franchisees. Only one company indicated that it had been involved in litigation with franchisees as a direct result of the law. Because there was only one respondent in this category, hypothesis tests (1f) cannot be done. However, the company that respondent in the affirmative indicated that the litigation concerned the following clauses of the law: applicability, dispute resolution, encroachment, non-renewal, and repurchase of assets.

None of the 36 participants in the study stated that they have experienced relief from litigation with franchisees as a result of the 1992 law, therefore no hypothesis tests could be done to determine which changes from the 1992 version to the 1995 version were helpful in regards to relief from litigation.

Furthermore, none of the participants indicated that they had experienced litigation with franchisees nor relief from litigation with franchisees as a direct result of the 1995 Amendments. It is therefore impossible to determine which clauses would be most influential in these situations, however it has already been discussed above in research question number three that the overall probability of experiencing additional

litigation or relief from litigation as a direct result of the 1995 amendments is extremely low (2f).

Research Question 5

How were franchisors impacted in terms of operational changes as a result of the law?

Question 9 addressed the hypothesis 1g, that there were no operational changes as a result of the 1992 law. Of the 36 respondents, 5.56% (2 companies) indicated they had made operational changes. A 95% confidence interval was calculated for the true proportion of companies that implemented operational changes as a result of the law; the lower confidence limit is 0 and the upper limit is 13.04. This lead to a failure to reject the null hypothesis (1g) since zero is contained in the interval.

The two companies who indicated they had made operational changes commented on them in question 9a. One company rewrote its franchise agreement to ensure compliance with the law, while the other company indicated that some of the franchisee developers stopped franchising altogether and others continue to operate as usual, without regard to the new law.

The final question on the survey asked respondents if they had made operational changes to the franchise system in response to the 1995 Amendments, and 100% answered "no". Since responses took on a constant value, a variance could not be calculated, which also means no hypothesis tests could be conducted. From a practical standpoint, one could say that the probability of making changes to operations as a result

of the 1995 Amendments is very low. No explanations were required in question 15a since none of the respondents indicated they had changed operations.

Validity, Reliability, and Non-response Bias

The survey was developed through consultation with an attorney, a food services franchisor, academic experts and franchise experts. These individuals were consulted in an attempt to ensure the validity of the scale, that is, to ensure that it measures what it is intended to measure. Because no academic research on the impact of franchise laws on expansion strategy has been published, there was no literature base to consult in the development of the survey instrument.

The author intended to conduct a Chronbach alpha test to determine the reliability of the Likert scale questions which measured the participant's attitude toward the nine clauses of the law (which ones were the most influential in expansion strategy changes). However, since only eight participants completed question 5a, one participant completed question 7a, and no participants completed questions 8a, 11a, 13a, and 14a, the sample size is too small to yield meaningful results.

Non-response bias was addressed by splitting the sample and separately analyzing early and late respondents (Armstrong & Overton, 1977). Thirty respondents were categorized as early and six as late, which resulted in sample sizes too small to perform the appropriate statistical tests. However, a review of the data revealed no substantial differences in the demographics between the two groups, with one exception. The late companies had a higher mean of franchised and total units in Iowa (Table 14). Of the early respondents, 31% changed their strategy as a direct result of the 1992 law while

only 16% of the late respondents did. This may seem contradictory since one would tend to expect that those with more franchised units in the state would change their strategy as discussed in research question one, however there is a logical explanation. First, only six participants were categorized as late, so one large respondent can have a significant impact on the descriptive statistics of the sample. As seen in Table 14, the mean number of franchised units for the late sample is 8.2 with a standard deviation of 17.8, which is twice the mean. This indicates a distribution that is not normal; in fact, one large company skewed the data for this particular sample. This one company has in fact adapted to the law in an attempt to bring in more franchisees. Responses to the 1995 amendments were similar for both samples.

Table 14

Split Sample Descriptive Statistics

Early Respondents

Category	Mean	Standard Deviation
Number of Years Franchising in US	21.87	13.19
US Company Owned Units	202.38	491.64
US Franchised Units	605.03	2164.11
US Total Units	784.50	2250.43
Iowa Company Owned Units	0.76	2.54
Iowa Franchised Units	1.00	2.75
Iowa Total Units	1.66	3.89

Late Respondents

Category	Mean	Standard Deviation
Number of Years Franchising in US	27.60	6.19
US Company Owned Units	149.00	319.35
US Franchised Units	628.17	665.44
US Total Units	777.17	902.10
Iowa Company Owned Units	0.00	0.00
Iowa Franchised Units	8.20	17.78
Iowa Total Units	8.20	17.78

Summary

This chapter reviewed all the research questions, hypotheses, and the statistical analyses performed for each survey question. A concise summary of the results is provided in Table 15. As discussed earlier, the sample was not fully representative of the restaurant franchisor market since the majority of respondents were small companies and hold a relatively small share of the restaurant market. Conclusions, recommendations and limitations of the study will be discussed in the following chapter.

CHAPTER FIVE

CONCLUSIONS AND RECOMMENDATIONS

Introduction

The preceding chapters presented the research questions, methodology, and an overview of the survey instrument as well as the results for the study. This chapter will include a summary of the findings, the conclusions, implications, limitations and recommendations for future research on this topic.

Summary of the Study

The purpose of the study was to investigate the consequences of the 1992 Iowa Franchise Act and its 1995 Amendments in terms of restaurant franchise expansion within the state. What started as a dispute for territorial rights ended in a law which required significant changes in how franchisors were to conduct business in Iowa (King, 1993b; Peterson, 1993) when two Iowa Kentucky Fried Chicken franchisees took their concerns to the state legislature. The key areas addressed in the law are transfer rights, encroachment, termination, non-renewal, jurisdiction of legal proceedings, sourcing, non-compete, repurchase of assets, and applicability (Iowa Code 523H, 1992). Since the passage of this law, various groups including the IFA and the ICRF have worked to have it repealed or reformed.

The author intended to determine the specific results of this legislation in terms of restaurant franchise expansion within the state, subsequent litigation with franchisees, and operational changes necessitated by the law.

As discussed in the review of literature (Chapter 2), studies conducted by the ICRF (1995, 1996) found that 133 companies had halted or restricted franchising in Iowa and that 70% of surveyed franchising system were not expanding in Iowa and intend to stay away from Iowa even with the passage of the 1995 amendments. Proponents of the law cited statistics from the state government which seemed to indicate that the law had little to no negative impact on the state or its economy. Despite the intense lobbying both on behalf of and against the law as well as an announced intention to discontinue franchising in the state as a result of the 1992 law, no published empirical research was found on the impacts of this law.

Overview and Discussion of Results

The data indicates that there were in fact changes to restaurant franchisor expansion strategy in Iowa as a result of the passage of the 1992 law, as well as changes to the level of new franchises granted in Iowa as a result of the law. These findings agree with the literature published by the ICRF (1995) on the impacts of the law. Of the 197 potential participants surveyed, 36 companies responded, yielding a response rate 18.27%. Over half (54%) of the participating companies did not franchise in Iowa, however, 23% of the participants halted or restricted franchising in the state, which is substantial. The ICRF study claimed that nearly 70% of the participants had halted or restricted franchising in the state, which is much larger than the percent found in this study. However, the ICRF had many more participants and did not limit their study to restaurant franchisors only, but included franchisors from a variety of businesses.

The results of this study indicate that there were no changes to the level of new company stores established in Iowa as a result of the law, which shows that the changed expansion strategies cited above and in the data fell squarely in the area of franchisee unit development rather than company unit development, which is not surprising since the law impacts only franchised units and not company owned units. There was no impact on the amount of litigation with franchisees or on the operational aspects of the business.

Data collected indicate a degree of differences in regards to which clauses of the law may have been influential in a decision to change expansion strategy, however because of the small number of responses appropriate hypothesis testing could not be conducted. The data did indicate that encroachment, non-renewal and noncompete/repurchase of assets clauses were among the most influential when making franchise expansion strategy decisions. These clauses confirm the franchisor view of the encroachment issue discussed in the literature review (Chapter 2). Encroachment is a big concern for both franchisees and franchisors. Franchisees are concerned that opening new units in their vicinity will adversely impact their sales, while franchisors are continually looking for ways to bring the product closer to the consumer (Kramer, 1995). Franchisors argue that more distribution units serve to increase customer recognition of the brand, resulting in benefits for both the franchisor and franchisee. In light of this argument, it would be expected that the encroachment clause of the law would play a significant impact on a franchisor's decision to open new franchisee units within the state.

The non-renewal clause is of concern as well. Franchisors have been forced to become increasingly creative with ways to attract consumers which sometimes results in

operational changes across the franchise system. Quite often, these changes require money, which may be present a burden to the franchisee and serve to cause tension in the franchise relationship. To ensure consistency across the franchise system and to reflect marketplace changes, a franchisor may wish to require franchisees who are up for renewal to sign a new contract with new requirements. The 1992 Iowa law prevented franchisors from enforcing non-compete clauses if they refused to renew a franchisee, which was influential in franchisor decisions to discontinue franchising in the state.

The noncompete/repurchase of assets clause was rated as a significant factor in changing franchise expansion strategy in Iowa. Franchisors include non-compete clauses in their contracts as a way to prevent individuals whom they train in every detail of a business from leaving the franchise system and going into direct competition with the franchisor. When the freedom to enforce these clauses is removed, franchisors may be placed in a delicate situation. Thorough training of franchisees and managers is essential for the success of the franchise system, however if franchisees leave the system, they take a wealth of knowledge with them, which can ultimately damage the franchise system in the form of direct competition. The 1995 amendments did loosen up restrictions on franchisors, which may have been a factor in a degree of increased willingness to franchise in the state.

The analysis of the data collected indicates that the 1995 Amendments had little to no significant impact on restaurant franchisor Iowa operational changes or litigation with franchisees, however there were changes to restaurant franchisor expansion strategies in Iowa as a result of the Amendments. The comments of participating companies indicated

a cautious approach toward new unit development in Iowa. While some are granting new franchisee units as a result of the changes, others have taken a “wait and see” attitude, and still others refuse to franchise until further reforms are passed. The 1995 amendments did have an impact on new unit development, however the direction of the impact is mixed; that is to say that some franchisors increased franchise development in the state while others did not.

Limitations of the Study

There were two major limitations of this study. The first is that the companies who chose to participate are representative of small franchisors. Over 80% of the participants had less than 500 units throughout the country and as a group do not hold the majority of the market share. Therefore, the results are applicable to small food service franchisors.

Second, though the response rate was at a level considered to be acceptable, the responses did not provide adequate data to test all the hypotheses. Had the study received full support and cooperation from the food service franchisors, results could have been more meaningful and more of the hypotheses could have been tested. Of particular importance was the inability to test which clauses of the laws were the most influential in franchisor expansion strategy decisions.

Implications

The results of the study suggest that the 1992 Iowa Franchise Law had an impact on subsequent restaurant franchisor growth in the state. This may be a factor in why several states have considered yet not passed similar laws (ICRF, 1996).

The 1995 amendments seemed to have some impact in regards to expansion, which may indicate that franchisors are willing to reconsider expansion strategies in light of these reforms.

Franchising is done throughout the United States, and this law impacted only one state, resulting in little overall direct impact to the franchise community. The implications are important, however. The Iowa law and subsequent court battles as well as decreases in granting franchised units serve as a model for how other states may be affected should similar legislation be enacted. The data show that while the establishment of company owned stores continued without change, the establishment of franchised units decreased significantly. Therefore the burden of these expansion strategy changes fell squarely on the area of franchisee expansion, which can serve to take revenue away from local economies. This eliminates opportunities for new small businesses, since many new small business owners prefer the option of opening a franchise (ALEC, 1996). Often the success rate is higher than opening an independent business and there is the added benefit of resources, training, and support from the franchisor. Furthermore, when a locally-owned franchisee makes a profit, that money is often reinvested in the surrounding community, while profits from company owned stores tend to be directed back to company headquarters, which may be located out of the state.

While the results are not generalizable to franchised businesses other than food service providers and are reflective of small food service franchisors, the results of this study may be applicable to states who are considering similar franchise laws and to corporations who may be impacted by such laws. According to the ALEC (1996), at least

30 states have considered and rejected similar legislation. Little research has been published on the impact of laws such as the Iowa Franchise Law. This study serves as an addition to the small but growing body of literature on the impact of franchise laws, and as a starting point for studies on the impact of franchise laws on franchisor expansion strategy.

Recommendations for Future Research

A complaint from franchisors was that the survey was too long and they did not have the time to complete it. For the sake of brevity and to assist in increasing response rate, future research should focus on expansion strategies impacted by laws such as the Iowa Franchise Law, as well as which specific clauses of the law are most influential in expansion decisions. The data did not provide a statistically significant in-depth look at how individual clauses of the law impacted expansion decisions made by the franchisor. It is the researcher's opinion that this particular issue is very important and warrants further investigation in light of the data presented and what is indicated by related literature. Changed levels of litigation with franchisees and changed operational aspects of the business as a result of the law were areas of little significance to the franchisors and do not warrant further investigation.

This study is representative of small food service franchisors who own less than 500 units. To determine impacts on larger franchisors, a case study would most likely yield the best results since some of the larger franchisors indicated that the survey was too long and that they did not have time to fill it out. Future case studies may wish to focus on franchised and company owned stores expansion rates before and after the 1992 and

1995 laws were enacted and which clauses of the law were influential in expansion strategy decisions. Comparisons with franchise growth in similar states before and after the laws would further advance research in the area of the impact of franchise legislation. It would also be useful to consider the business and economic impacts of these laws on existing franchisees in the state.

Contributions

This study presented empirical evidence that the 1992 Iowa franchise law did indeed have an impact on overall franchisors expansion strategy with specific impact in regards to granting new franchised units. This has serious implications for the franchising community and for states who are considering similar legislation.

The survey instrument itself is a significant contribution of the study. It was carefully developed through consultation with an attorney, a food service franchisor, academic experts, and franchise experts. This research tool can be modified and implemented in future research.

Summary

A total of 197 food service franchisors were surveyed by using a questionnaire. Thirty-six organizations participated in the study, yielding a response rate of 18.3.%. It was found that the level of new franchise units granted in Iowa was indeed impacted by the passage of the 1992 Iowa Franchise Law, however litigation levels and operational changes were not impacted by the law. The 1995 amendments served to change expansion in the state, though the impacts were not as apparent as those of the 1992 law.

The 1995 amendments did not influence the amount of litigation with franchisees nor operations of food service franchisors.

References

Allen, R. L. (1992). Franchise legislation facing radical change: Bills in 19 states target business relationships between restaurant franchisees and franchisors. Nation's Restaurant News, 26 (38), 1, 158.

American Legislative Exchange Council. (1996). Restrictive Franchising Laws. The State Factor, 22 (6).

Anonymous (1996). Franchisee vs. Franchisor: Balancing the scales. Nation's Business, 84 (10), 63.

Anonymous. (1995, July). R&I Top 400. Restaurants & Institutions, 105 (16), 42-86.

Anonymous. (1995, August 7). The Top 100. Nation's Restaurant News, 29 (31), 81-144.

Anonymous. (1995, August 23). Domino's violates antitrust law, franchisees claim. [On-line]. Available: http://www.ifis.com/ifis/new/pizza2.html.

Anonymous. (1995). Iowa franchise law reform bill passes, house: US Supreme Court refuses appeal. Franchising World, 27 (2), 38.

Anonymous. (1994, July 25). Iowa Franchise Law Held Unconstitutional. The National Law Journal, D3.

Anonymous. (1993). Popeye's Open in Wal-Mart. Franchising World, 25 (6), 16.

Armstrong, J. and Overton, T. (1977). Estimating non-response bias in mail surveys. Journal of Marketing Research, 14 (August), 396-402.

Bernstein, C. (1994). Franchising: explosive issues fuel debate. Restaurants & Institutions, 104 (24), 61.

Brickley, J., Dark, F., and Weisbach, M.. (1991). The economic effects of franchise termination laws. Journal of Law and Economics, 34 (1), 101-132.

Brown, H. (1995, July 25). Iowa's revised statute on conduct. New York Law Journal, 3.

Bureau of National Affairs. (1995). Iowa supreme court construes franchise act in attack on constitution. BNA Antitrust and Trade Regulation Report, 69 (1732), 394.

Caggiano, C. (1995). The collectively bargained franchise agreement. Inc., 17 (16), 73-75.

Chase, B. (1991). Franchisees seek legislative protection. Business Record, 87 (42), 1.

Committee on Small Business. (1990). Franchising in the U.S. Economy: Prospects and Problems. U.S. House of Representatives, 101st Congress, 2d session, September 1990.

Couch, M. (1996, February 4). Restaurants open at fast rate as franchise law is sorted out. The jury is still out on what effect Iowa's tough rules have had on the industry. The Des Moines Register, p. 4.

Diamond, S.A. (1969, October 27). Federal Trade Commissioners warn of abuses in franchising. Marketing Insights, p. 17.

Gleim, I. and Jordon, B. (1995). Business Law/Legal Studies, Chapter 37. http://www.gleim.com/BusinessLaw/Government/Antitrust.html

Goodhard, K. (1992, Summer). The New Iowa Franchise Law: franchisors (and franchisees) beware. Franchise Law Journal 18.

Hess, D. (1995). The Iowa Franchise Act: Towards Protecting Reasonable Expectations of Franchisees and Franchisors. Iowa Law Review, 80, 333-362.

Hogan, B. (1993). Franchise Wars. D&B Reports, 42 (5), 40-42.

International Franchise Association. (1995). Franchise Fact Sheet.

International Franchise Association. (1996). Franchise Opportunities Guide, 1996 Edition. Washington D.C.: International Franchise Association.

Iowa Coalition for Responsible Franchising. (1995). 1995 Iowa Franchise Report. West Des Moines: Iowa Coalition for Responsible Franchising.

Iowa Coalition for Responsible Franchising. (1996). 1996 Iowa Franchise Update. West Des Moines: Iowa Coalition for Responsible Franchising.

Iowa code 523H, Franchise Agreements. 1992 Iowa Acts 1134 (codified at Iowa Code 523H.1-.17 (1993))

Iowa code 523H, Laws of 1995, House File 126 (codified at Iowa Code 523H.1-.17).

Judge tosses out lawsuit on ingredients supplied by Domino's. (1996, May 3). The Wall Street Journal, p. B11(E).

Justis, R.T. and Judd, R. (1986). Master Franchising: A new look. Journal of Small Business Management, 24 (3), 16-21.

Justis, R. (1989). Franchising. Cincinnati, OH: South-Western Publishing Co.

Kaufmann, D. (1990a). New York Franchise Act celebrates 10th anniversary. New York Law Journal, September 5, 1.

Kaufmann, D. (1990b). Franchising is alive and well, so let's kill it. New York Law Journal, September 25, 2.

Khan, M. (1992). Restaurant Franchising Von Nostrand Reinhold, Inc.: New York.

King, J. (1993a). Iowa become battlefield for franchise legislation. Business Record, 89 (14), 10.

King, J. (1993b). Franchise Companies welcome court ruling. Business Record, 89 (22), 3.

King, J. (1994). Iowa Franchise Act in national light. Business Record, 90 (31), 3.

King, J. (1995). Franchise companies may return to Iowa. Business Record, 91 (19), 8.

Kramer L. (1995). Popeye's to open outlets in Kroger supermarkets. Nation's Restaurant News, 29 (28), 1.

Law and Leading Attorney Web. (1996, October 6). The UFOC. [On-line]. Available: http://www.lawlead.con/minnesota/business/chapters/619.html.

Mandt, M. E. (1992). The Economic Effects of Franchise Termination Laws. (Thesis, University of Georgia, 1992).

Martin, R. (1995). The Second 100. Nation's Restaurant News, 29 (33), 49-68.

Mendelshon, M. (1992). The Guide to Franchising. New York: Cassell Publishing

Oleck, J. (1992). The Battle for Iowa. Restaurant Business, 91 (8), 78-92.

Oleck, J. (1993a). 'Grassroots' group aims to undo franchise law: historic Iowa legislation is target of coalition. Restaurant Business, 92 (7) 22.

Oleck, J. (1993b). Iowa franchise interests await appeal ruling: McDonald's wants District Court upheld. Restaurant Business, 92 (10), 43.

Peterson, J. (1993). Business meals return to the gilded age. Business Record, 89 (48), 14.

Prewitt, M. (1995). Franchisees' Lawsuits: Chains nontraditional growth paths lead to new encroachment battles. Nation's Restaurant News, 29 (40). 118-120.

Purvin, R. (1994). The Franchise Fraud. New York: John Wiley & Sons, Inc.

Regulation of the Franchising Industry: Hearings before the Federal Trade Commission House Energy/Transportation and Hazardous Materials, 104th Cong., 2d Sess. (1994) (testimony of C. White).

Regulation of the Franchising Industry: Hearings before the North American Securities Administrators Association House Energy/Transportation and Hazardous Materials Federal Trade Commission, 104th Cong., 2d Sess. (1994) (testimony of Steve Maxey).

Runkel, P. J., and McGrath, J. E. (1972). Research on Human Behavior: A Systematic Guide to Method. New York: Holt, Rinehart & Winston.

Saporito, B. (1995). What's for dinner? The battle for stomach share. Fortune, 131 (9), 50-56.

Serwer, A. (1995). Trouble in franchise nation. Fortune, 131 (4), 115-129.

Shay, M. (1996). Vote to keep franchising strong. Franchising World, 28 (4), 12-13.

Sherry, J. (1996). Antitrust implications of food-service franchising agreements. Cornell Hotel and Restaurant Administration Quarterly, 37 (4), 18-19.

Siegal v. Chicken Delight, Inc., 448 F 2nd. 43 (9th Cir. 1974).

Tannenbaum, J. (1995, July 5). Franchisees balk at high prices for supplies from franchisors. The Wall Street Journal, p. B1.

Taylor, G. (1992). Franchise reform to yield feast. The National Law Journal, January 20, 1.

U.S. Constitution, art.1, section 10, clause 1 (1787).

Wall, S., and Wieczorek, D. (1993, July 12). New disclosure guidelines await review. The National Law Journal, 19.

Whittemore, M. (1994). Winds of change in franchising. Nation's Business, 82 (1) 49.

Wieczorek, D. (1995, Fall). The Iowa Franchise Law: 1995 Amendments and some proposals for 1996. Franchise Law Journal, 43-50.

Zikmund, W. (1997). Business Research Methods. (Fifth Edition). Orlando: The Dryden Press.

Appendix A
Letter of Request for Participation

Company Name
Franchise Development
Address

January 27, 1997

Dear (contact name):

I am a graduate student in the Hospitality and Tourism Management program at the Virginia Polytechnic Institute and State University. To fulfill my graduation requirements, I am researching the impact of the Iowa Franchise Law on restaurant franchisor expansion strategy in Iowa. I wish to have your support in this research project.

The attached 15-item questionnaire asks for your company's response to the 1992 Iowa Franchise Act and the 1995 Amendments, their general impact on your expansion strategy, litigation with franchisees, and operational processes. I ask that you please read and complete the survey. A return envelope is enclosed for your convenience.

Franchise law is now in the spotlight as never before at both the state and federal levels. Several franchise organizations, to include the International Franchise Association, have provided input and (non-financial) support for this study and are anxious to see the results. Your participation in this research will be invaluable in demonstrating what impact, if any, the Iowa Franchise Law has had on restaurant franchisor growth and what clauses of the law were most influential in making expansion decisions. Furthermore, the final results of this research will enable legislative bodies considering franchise legislation to consider the possible consequences of their decisions in terms of franchise growth in their communities.

Thank you for your time and attention. Please complete the enclosed survey and return it in the envelope provided. I will send you a summary of the study's results upon its completion (May 1997) as my way of saying "thanks" for your help. Please contact me at the above address or on the internet at: ahurst@mail.vt.edu if you have any questions.

Sincerely,

Angela L. M. Hurst

Attachment:
Survey

Appendix B
Follow up Letter

March 6, 1997

Dear Franchisor:

A few weeks ago, you were sent a survey which requested your company's responses to the 1992 Iowa Franchise Law and its 1995 Amendments. I am writing to request that you please fill out the questionnaire and return it to me as soon as possible. Your company's participation is vital in order to gain accurate insight as to the precise effects the law has had on restaurant franchise expansion within the state of Iowa. Your responses will be invaluable in demonstrating what impact, if any, the Iowa Franchise Law has had on restaurant franchisor growth and what clauses of the law were most influential in making expansion decisions. Furthermore, the final results of this research will enable legislative bodies considering franchise legislation to consider the possible consequences of their decisions in terms of franchise growth in their communities.

If you have already returned your completed survey, thank you for your time. I will be sure to send you a summary of the results once the study in completed in April/May 1997. If not, please ensure that your company is represented in this study. You can be assured that your responses will not be associated with your company name in any publications of the study.

Thank you for your time and attention. If you have any questions or concerns, or would like an another copy of the survey, please contact me at the above address or fax (540) 231-8313.

Sincerely,

Angela L.M. Hurst

Appendix C
Survey Instrument
<u>Please answer all the questions</u>

Section I: General Information

Name of company *(optional):* ____

1. How many years has your company been franchising in the United States? ______

2. How many units does the company currently have established in the United States?

   a) Company owned ______ b) Franchised ______ c) Total ______

3. How many units were established in the state of Iowa in 1996 (projected through December 1996)?

   a) Company owned ______ b) Franchised ______ c) Total ______

Section II: The 1992 Iowa Franchise Law, Its Impact and Company Response

4. Has the company changed its short or long term overall expansion strategy in Iowa as a direct result of the 1992 Iowa law? (Circle correct response)

   a) Yes b) No

   4a. If 'YES', these changes were/will be implemented by: (Circle all that apply)

   a) Changing the rate of new unit development in the state
   b) The formation of alliances
   c) Participation in dual branding
   d) Other:____
   ____
   ____

5. Did the company decide to change the rate at which they granted *new franchisee stores* in Iowa after *the 1992 Iowa Franchise Law* was implemented? (Circle correct response)

   a) Yes, completely halted granting new franchisee stores
   b) Yes, restricted the level of new franchisee stores granted (specify restrictions):
   ____
   ____
   ____
   c) Yes, increased the level of new franchisee stores granted
   d) Yes, began granting new franchisee stores for the first time after the law was implemented
   e) No, continued granting new franchisee stores with no change
   f) Did not franchise in Iowa in 1992
   g) Other:____
   ____
   ____

5a. If 'YES', the changes made in granting *new franchisee stores* in the state of Iowa after the passage of the *1992 Iowa Franchise Law* were driven by the: (please see appendix for details on each clause of the law)

Please circle the appropriate response for all items (on a seven point scale)

	Strongly Disagree			Neither Agree nor Disagree			Strongly Agree
a) Applicability clause	1	2	3	4	5	6	7
b) Dispute resolution clause	1	2	3	4	5	6	7
c) Transfer clause	1	2	3	4	5	6	7
d) Encroachment clause	1	2	3	4	5	6	7
e) Non-renewal clause	1	2	3	4	5	6	7
f) Noncompete clause	1	2	3	4	5	6	7
g) Repurchase of assets clause	1	2	3	4	5	6	7
h) Termination clause	1	2	3	4	5	6	7
i) Sourcing clause	1	2	3	4	5	6	7
j) Other ________________	1	2	3	4	5	6	7

6. Did the company change the rate at which it established *company owned stores* in Iowa after the implementation of the *1992 Iowa Franchise Law*? (Circle correct response)

a) Yes, completely halted establishing company owned stores

b) Yes, restricted the establishment of company owned stores granted (specify restrictions):

____

____

____

c) Yes, increased the amount of company owned stores

d) Yes, began establishing company owned stores for the first time after the law was implemented

e) No, continued establishing company owned stores with no change

f) Did not have company owned stores in Iowa in 1992

g) Other:____________________________________

____

____

7. Has the company been involved in litigation with franchisees as a direct result of the implementation of the 1992 Iowa Franchise Law? (Circle correct response)

a) Yes b) No

7a. If 'YES', this litigation concerned which of the following clauses of the law:

Please circle the appropriate response for all items (on a seven point scale)

	Strongly Disagree			Neither Agree nor Disagree			Strongly Agree
a) Applicability clause	1	2	3	4	5	6	7
b) Dispute resolution clause	1	2	3	4	5	6	7
c) Transfer clause	1	2	3	4	5	6	7
d) Encroachment clause	1	2	3	4	5	6	7
e) Non-renewal clause	1	2	3	4	5	6	7
f) Noncompete clause	1	2	3	4	5	6	7
g) Repurchase of assets clause	1	2	3	4	5	6	7
h) Termination clause	1	2	3	4	5	6	7
i) Sourcing clause	1	2	3	4	5	6	7
j) Other ________________	1	2	3	4	5	6	7

8. Has the company experienced relief from litigation with franchisees as a result of the 1992 Iowa Franchise Law? (Circle correct response)

a) Yes b) No

8a. If 'YES', this relief was a result of changes in which of the following clauses of the law: (please see appendix for details on each clause of the law)

Please circle the appropriate response for all items (on a seven point scale)

	Strongly Disagree			Neither Agree nor Disagree			Strongly Agree
a) Applicability clause	1	2	3	4	5	6	7
b) Dispute resolution clause	1	2	3	4	5	6	7
c) Transfer clause	1	2	3	4	5	6	7
d) Encroachment clause	1	2	3	4	5	6	7
e) Non-renewal clause	1	2	3	4	5	6	7
f) Noncompete clause	1	2	3	4	5	6	7
g) Repurchase of assets clause	1	2	3	4	5	6	7
h) Termination clause	1	2	3	4	5	6	7
i) Sourcing clause	1	2	3	4	5	6	7
j) Other ________________	1	2	3	4	5	6	7

9. Were operational changes (changes to competitive methods, production and selling methods) made to the franchise system in response to the 1992 Iowa Franchise Law? (Circle correct response)

a) Yes b) No

9a. If 'YES', why were operational changes necessary?

____
____
____
____
____

Section III: The 1995 Amendments, The Impact and Company Response

10. Has the company changed its short or long term expansion strategy in Iowa as a direct result of the 1995 Amendments? (Circle correct response)

a) Yes b) No

10a. If 'YES', these changes were/will be implemented by: (Circle all that apply)

a) Changing the level of new unit development in the state
b) The formation of alliances
c) Participation in dual branding
d) Other ________________________________
____
____

11. Did the company decide to change the rate at which they granted *new franchisee stores* in Iowa after the *1995 Amendments* were implemented? (Circle correct response)

a) Yes, completely halted granting new franchisee stores
b) Yes, restricted the level of new franchisee stores granted (specify restrictions):
____
____
c) Yes, increased the level of new franchisee stores granted
d) Yes, began granting new franchisee stores for the first time after the law was implemented
e) No, continued granting new franchisee stores with no change
f) Did not franchise stores in Iowa in 1995
g) Other:_______________________________________
____
____

11a. If 'YES', the changes made in granting *new franchisee stores* in the state of Iowa after the passage of the *1995 Amendments* were driven by the: (please see appendix for details on each clause of the law)
Please circle the appropriate response for all items (on a seven point scale)

	Strongly Disagree			Neither Agree nor Disagree			Strongly Agree
a) Applicability clause	1	2	3	4	5	6	7
b) Dispute resolution clause	1	2	3	4	5	6	7
c) Transfer clause	1	2	3	4	5	6	7
d) Encroachment clause	1	2	3	4	5	6	7
e) Non-renewal clause	1	2	3	4	5	6	7
f) Noncompete clause	1	2	3	4	5	6	7
g) Repurchase of assets clause	1	2	3	4	5	6	7
h) Termination clause	1	2	3	4	5	6	7
i) Sourcing clause	1	2	3	4	5	6	7
j) Other ______________	1	2	3	4	5	6	7

12. Did the company change the rate at which it established *company owned stores* in Iowa after the implementation of the *1995 Amendments*? (Circle correct response)

a) Yes, completely halted establishing company owned stores
b) Yes, restricted the establishment of company owned stores granted (specify restrictions):
____
____
____
c) Yes, increased the amount of company owned stores
d) Yes, began establishing company owned stores for the first time after the law was implemented
e) No, continued establishing company owned stores with no change
f) Did not have company owned stores in Iowa in 1995
g) Other:_______________________________________
____
____

13. Has the company been involved in litigation with franchisees as a direct result of the implementation of the 1995 Amendments? (Circle correct response)

a) Yes b) No

13a. If 'YES', this litigation concerned which of the following clauses: (please see appendix for details on each clause of the law)

Please circle the appropriate response for all items (on a seven point scale)

	Strongly Disagree			Neither Agree nor Disagree			Strongly Agree
a) Applicability clause	1	2	3	4	5	6	7
b) Dispute resolution clause	1	2	3	4	5	6	7
c) Transfer clause	1	2	3	4	5	6	7
d) Encroachment clause	1	2	3	4	5	6	7
e) Non-renewal clause	1	2	3	4	5	6	7
f) Noncompete clause	1	2	3	4	5	6	7
g) Repurchase of assets clause	1	2	3	4	5	6	7
h) Termination clause	1	2	3	4	5	6	7
i) Sourcing clause	1	2	3	4	5	6	7
j) Other ________________	1	2	3	4	5	6	7

14. Has the company experienced relief from litigation with franchisees as a result of the 1995 Amendments? (Circle correct response)

a) Yes b) No

14a. If 'YES', this relief was a result of changes in which of the following clauses of the law: (please see appendix for details on each clause of the law)

Please circle the appropriate response for all items (on a seven point scale)

	Strongly Disagree			Neither Agree nor Disagree			Strongly Agree
a) Applicability clause	1	2	3	4	5	6	7
b) Dispute resolution clause	1	2	3	4	5	6	7
c) Transfer clause	1	2	3	4	5	6	7
d) Encroachment clause	1	2	3	4	5	6	7
e) Non-renewal clause	1	2	3	4	5	6	7
f) Noncompete clause	1	2	3	4	5	6	7
g) Repurchase of assets clause	1	2	3	4	5	6	7
h) Termination clause	1	2	3	4	5	6	7
i) Sourcing clause	1	2	3	4	5	6	7
j) Other ________________	1	2	3	4	5	6	7

15. Were operational changes were made to the franchise system in response to the 1995 Amendments? (Circle correct response)

a) Yes b) No

15a. If 'YES', why were operational changes necessary?

____

____

1992 IOWA FRANCHISE LAW	1995 AMENDMENTS
Applicability: Applies to all new and existing franchises; does not apply to contracts between Iowa franchisors and out of state franchisees	*Applicability:* Unchanged
Dispute Resolution: Right of venue in Iowa	*Dispute Resolution:* Unchanged
Transfer: Franchisor must allow transfer if transferee satisfies the qualifications for new franchisees; franchisor has 60 days to approve transfer; may impose a transfer fee, has right of first refusal; may not interfere with public offerings without good cause; succession to heir is not considered a transfer	*Transfer:* Transferee must meet current qualifications for new franchisees; franchisor may impose financial requirements; public offering clause struck out; succession to heir not considered a transfer, however heir must meet qualifications of the franchisor within one year
Encroachment: Restaurant franchisors may not open a store within the a 3 mile radius or 30,000 population base without allowing franchisee right of first refusal or compensation for lost market share as determined by appraisers	*Encroachment:* Nullified the 3 mile/30,000 rule; established adverse impact guidelines of 5% on annual gross sales of impacted franchisee during the first 12 months of the new unit's operation; burden of proof lies with franchisee
Non-renewal: Franchisor may not refuse to renew without at least six months notice and one of the following conditions exist: a) good cause b) the parties agree not to renew and the noncompete covenant is waived or c) the franchisor is withdrawing from the area and the noncompete covenant is waived.	*Non-renewal:* May require franchisee to meet current requirements for new franchisees and sign a new contract; 1992 restrictions a, b and c apply, however the franchisor may enforce the non-compete covenant if the parties agree not to renew (as outlined in 'b')
Non-compete: Franchisors are prohibited from enforcing noncompete clauses after a termination or nonrenewal unless: a) the franchisee opens a business that relies on a substantially similar marketing program to that of the franchisor or b) the franchisor offered to purchase the assets of the business at fair market value	*Non-compete:* Can enforce unless franchisor completely withdraws from the area
Repurchase of Assets: Franchisee may engage in any lawful business after termination or non-renewal unless program is similar to the franchisors or franchisor offers to purchase the business at fair market value	*Repurchase of Assets:* Unchanged, however it now does not apply to assets of the franchised business which the franchisee did not purchase from the franchisor
Termination: May terminate only for good cause, may not act in arbitrary manner; must provide a 'get well' period of 30-90 days unless franchisee is declared bankrupt, has abandoned the business, fails to comply with the same material provision of the contract, etc.	*Termination:* Burden of proof for 'arbitrary actions' rests with franchisee; non-payment of fees cure time need not exceed 30 days; after 3 material breaches of the contract within a 12 month period franchisor may terminate provided franchisee had been given opportunity to cure.
Independent Sourcing: Allows franchisee to purchase supplies, equipment, services, etc. from sources of franchisee's choosing	*Independent Sourcing:* Unchanged

VITA

Angela Hurst was born on May 26, 1969 in Richmond, Virginia. In August 1991, she graduated with a Bachelor of Science in Exercise and Sport Science from the Pennsylvania State University.

She has served as an officer in the United States Air Force since her commissioning in 1991. Her duty stations to date include Fairchild Air Force Base, Washington; Kelly Air Force Base, Texas; and Blacksburg, Virginia. She has gained experience in all aspects of military hotel, dining facility, and wellness center management; disaster preparedness and response; and wartime food service, lodging, and recreation operations.

She competed for and earned an appointment to the Air Force Institute of Technology Civilian Institute program and subsequently joined the Masters of Science program offered by the Department of Hospitality and Tourism Management at Virginia Polytechnic Institute and State University in Fall 1995. During her course of study, she served as the Secretary and Treasurer of the Graduate Hospitality and Tourism Association, published three articles and presented a paper at a conference.

Upon completion of the program, she will continue her Air Force duties at the Air Force Institute of Technology Civil Engineering and Services School, Wright-Patterson Air Force Base, Ohio.

Angela L. M. Hurst